Acknowledgement

Firstly, I would like to thank to my supervisor Professor Dr Mohd Nazari Ismail for giving valuable advice and guidance during the preparation of the consultancy research report on the Credit Guarantee Scheme.

Secondly, I would like to give my gratitude to staff and management of Bank Perusahaan Kecil dan Sederhana Malaysia Berhad for sharing the valuable information and great cooperation.

Lastly, I would like to record my appreciation to my parent and family for their support and understanding during the completion of MBA program and the research report.

Executive Summary

<u>A brief description of Bank Perusahaan Kecil dan Sederhana Malaysia Berhad (SME Bank) and Credit Guarantee Scheme (CGS)</u>

Bank Perusahaan Kecil dan Sederhana Malaysia Berhad or better known as SME Bank was established more than 30 years ago as Bank Industri dan Infrastruktur Malaysia Berhad. SME Bank is a Development Financial Institution and 100% owned by Ministry of Finance Incorporated and Ministry of Industrial and International Trade acts as the Supervising Ministry.

As a Government Agency, SME Bank has its mandated role to provide financing as well as financial and business advisory services to Malaysian SMEs residing within predefined categories which have been framed within the SME classification guidelines of the National SME Development Council. Currently, SME Bank 19 branches throughout the country.

SME has a vision 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 the Government's aspirations. To achieve this vision, the management and employees of the Bank will collaborate with its network of strategic partners and providers to focus on becoming the centre of knowledge and expertise on the financing and growth needs of Malaysian SMEs in achieving its mission as the SME Hub.

Credit Guarantee Scheme is one of the innovations that SME Bank is offering to support the potential SMEs in obtaining financing from the Commercial Banks. SME Bank will provide the guarantee for the borrower to get their financing from the lenders, whereby here is known as the Participating Financial Institutions.

A brief description of the problem/issues identified

The Credit Guarantee Scheme was offered to the public in November 2006, whereby CIMB Berhad acts as the Participating Financial Institution. For the first 3 years of operations, few issues have been identified during the research. This requires the management of SME Bank to implement new approaches for improvement of the scheme for the Bank as the guarantor, the Participating Financial Institution as the lender and customer as the borrower.

Firstly, the problem is due to reduction in approval rate of the scheme significantly recently that causes drop in the fee-based income of the Bank. Secondly, there is occurrence of loan default that cause claim payment to be incurred by the Bank. Lastly, due to the high claim payment rate, the balance of Guarantee Fund Account is depreciated within less than 4 years in operations. The amount of Letter of Guarantee issued also decrease significantly. This huge decrease has directly impacted on amount of fee-based income generated from the Credit Guarantee in the year under review. Furthermore, the higher rate of claims payment causes reduction in the balance of Guarantee Fund Accounts, which reduce the capacity of SME Bank to issue further credit guarantee to the potential customers.

The management is monitoring the progress and require recommendations from the research since it causes the scheme to be no longer viable to operate during the period under review. The issues need to be resolved by the management of the Bank to ensure the relevancy and viability of the scheme to the customers and the Bank. This will be explained further in the subsequent sections in the research paper.

A snapshot of the analysis, findings and recommendations

Based on the analysis, the approval of Credit Guarantee has dropped significantly to only 2 approvals amounting RM 1.5 million in 2009 compared to the highest of 64 approvals amounting RM 59.4 million in 2007. The amount of Letter of Guarantee issued also decrease significantly to RM 1.6 million compared to the highest in 2007 amounting RM 31.75 million. This huge decrease has directly impacted on amount of fee-based income generated from the Credit Guarantee in the year under review.

The percentage of potential and actual claims payment against amount of Letter of Guarantee issued is 47%, and commitment is very high to SME Bank. Due to the high claim payment rate, the balance of Guarantee Fund Account is depreciated to RM 31.5 million compared initially RM 50 million in 2006 within 3 years in operations.

Issues are identified and analysed during the research, and a number of recommendations and suggestions have been discussed with management of the Bank. Among the suggestions are to revise the workflow of the credit guarantee's operations, including the policy and procedures. The Key Performance Indexes need to be

implemented to every staff involved to ensure the effectiveness and efficiency running the scheme. Concentration should be given more on good existing customers than those that do not have any track records with the Bank.

Besides that, the management is suggested to impose additional securities and advised to regularly visit their borrower. Internal discussion should be performed regularly and immediate corrective actions need to be in place. Regular discussion with the Participating Financial Institution is required to ensure that joint responsibility on the loan is imposed. There is a need to revise the contractual agreement with the Participating Financial Institution including risk-sharing basis in the event of loan default.

Lastly, the management is advised to revisit the manpower requirement and organisational chart of the related functions to ensure that the available resources is utilising towards the objective of the scheme.