CHAPTER I

INTRODUCTION

1.1 Background Of The Study

Smaller business enterprises in both industrialized and developing countries have difficulties in obtaining financial assistance from banks and financial institutions. In fact, studies have shown that most enterprises start their existence without any institutional help. The entrepreneur usually obtains the small amount of finance he needs from his own savings or from his family. However, small enterprises find it difficult to grow without the opportunity to borrow from lending institutions.

The reasons why small enterprises have limited access to institutional finance are well known. They are :

(1) Lending to small enterprises is considered to be risky. The uncertainties facing small industry, the high mortality rate of such enterprises and their vulnerability to market and economic changes make banks reluctant to deal with them, and there is a parallel reluctance on the part of small-scale enterprises (SSE) to borrow from banks.

(2) Banks and financial institutions are biased in favour of lending to large corporate borrowers. In some countries there are links between banks and corporate borrowers that take the forms of joint directorships, joint ownerships, and various other joint financial dealings.

(3) The administrative costs of lending to small enterprises are high and cut deep into the profitability of such loans.

(4) Small enterprises seeking loans are unable or unwilling to provide accounting records and other documentation required by banks, or to provide securities or collateral for the loans.

In an attempt to overcome some of these problems, particularly the perceived high risks of lending to small enterprises and their inability to provide collateral, credit guarantee schemes have been introduced.

The Credit Guarantee Corporation (Malaysia) Berhad was established in Malaysia on July 5, 1972 with the primary objective of providing guarantee cover on commercial loans by financial institutions so as to encourage them to lend to small and medium - scale enterprises (SMEs) which have no or inadequate collateral. It was established as a limited company with a paid-up share capital of RM 2.6 million (RM 22.6 million after restructing in 1994). Shares were held jointly by Bank Negara, 37 commercial banks and 40 licensed finance companies in Malaysia.

1.2 Objectives Of Credit Guarantee Schemes

Credit guarantee schemes are set up with the purpose of covering some portion of the losses incurred when borrowers default on loans. The purpose of such schemes is to encourage financial institutions, and in particular commercial banks, to lend to small businesses with viable projects and good prospects of success but which are unable to provide adequate collateral or which do not have a suitable record of financial transactions to prove that they are creditworthy. In some cases the schemes provide guarantees only for loans for investment in fixed assets; in others the schemes guarantee loans for working capital as well. The Canadian and French schemes, for example, specifically exclude guarantees for working capital. The majority of guarantees given in Japan, on the other hand, are for working capital loans. In most industrialized countries, guarantee schemes for loans for fixed assets or for working capital, or both, are the main form of government assistance to the small business sector. Such schemes operate in the United States, Canada, Japan, Australia, New Zealand, and in virtually all the countries of Western Europe[1].

The basic feature of most guarantee schemes is that the risk of loss is shared in an agreed proportion between the lender and the guarantee organization. It is often argued that healthy financial institutions, and particularly commercial banks, should extend a certain amount of unsecured credit - that is, loans without adequate collateral - on the basis of knowledge of, and belief in, a particular borrower's business capacity and economic prospects.

1. Levitsky, Jacob, et. al., Credit Guarantee Schemes For Small and Medium-sized Enterprises, World Bank Technical Paper Number 58, Washington D.C., 1990.

However, some commercial banks who look with disfavour on guarantee schemes claim that, in many cases, those who receive guarantees are often borrowers who would have been able to obtain loans under normal procedures. Even when a guarantee fund is in operation, lending institutions often prefer to obtain pledges of collateral from borrowers rather than relying exclusively on guarantees.

Nevertheless, many countries have been attracted to the idea of introducing guarantee schemes in the belief that they encourage commercial lending institutions to be less stringent in demanding collateral and so make them readier to lend to small enterprises.

1.3 Focus Of The Study

The objective of the study is to :

(i) discuss the successes and failures of credit guarantee schemes in other countries in the world and whether our CGC can learn some useful lessons from their experiences;

(ii) evaluate the role of CGC in financing the SMEs through the various schemes introduced by CGC over a period of 20 years (1973 - 1993) and

(iii) do a case study on the accessibility and lending operations of the CGC's guarantee schemes in financing the small and medium scale enterprises in Seremban, Negeri Sembilan to identify some probblems commonly faced by the bankers as well as by the borrowers of the various CGC schemes and to compile some suggestions for making the CGC schemes more effective ;

with the aim that answers to some existing problems faced by the CGC can be found so that CGC can make an even more significant contribution to the development of the Small and Medium-sized Enterprises.

1.4 Methodology And Organization Of The Study

Against the background set out above, the objectives of the study are to present :

i) a review on researches done on the credit guarantee schemes in other countries as well as in Malaysia; a macro view of the credit guarantee schemes (i.e. credit guarantee schemes of other countries in the world and also of Malaysia) will be obtained from various sources like books, working papers, seminar reports , meeting minutes reports and annual reports ; and this will be presented in Chapter II ;

ii) the development of Credit Guarantee Corporation (Malaysia) Berhad [CGC (M) Bhd.] which will be presented in Chapter III ;

and evaluate :

i) the role of CGC (M) Berhad in financing the Small And Medium-Scale Enterprises in Malaysia and the data for this will be obtained from secondary sources like the CGC Annual Reports (1973 - 1993), the Bank Negara Malaysia Annual Reports (1973 - 1993) as well as some additional unpublished data from the CGC (M) Berhad. The above information will be analyzed using time-series analysis and will be presented in the forms of cross tabulation, statistical analysis and graphical representation. This part of the study will be presented in Chapter IV .

ii) The micro view of the CGC will be presented in a Case Study on the accessibility and lending operations of the various CGC guaranteed loans and also on problems faced by the bankers and the CGC borrowers in Seremban. The case study will be conducted by personal in-depth interviews with loan officers or managers of twelve commercial banks in Seremban. This part of the study will be presented in Chapter V.