CHAPTER III

CREDIT GUARANTEE CORPORATION (MALAYSIA) BERHAD - DEVELOPMENTS

3.1 Background leading to the formation of the CGC

Under the Second Malaysia Plan and also the Third Malaysia Plan, the primary objectives of the Government is to eradicate poverty and to restructure society. The eradication of poverty would involve improving the productivity and income of the rural and urban poor through the acquisition of skills, land and capital; while the restructuring of society would entail correcting the economic imbalance between the various communities by providing , by 1990, for a 30 % Bumiputra participation in industry and commerce. The Government has formulated various plans and established various institutions like UDA, MARA, NPC, Bank Pertanian, MIDF, Bank Pembangunan Malaysia Berhad and various other institutions (See Appendix II) for the purpose of providing capital, training facilities, and other facilities to the rural and urban poor as well as the Bumiputra in order to realise these objectives. The private sector is also expected to play its role by complementing the efforts of the Government in realising these objectives and in the private sector, it is without doubt that the commercial banks, as an institution, would be the major source through which funds should flow to the deserving rural and urban poor and with their wide branch network and vast lending experience it is hoped that the Government's be achieved. With this background, it can be visualised how important the role that the commercial banks are expected to play in providing funds to the "small entrepreneurs" and to the Bumiputras.

Traditionally, the commercial banks have shown reluctance in providing loans and advances to the small entrepreneurs due to the high risks involved especially when collateral for securing these loans are not easily available. While this attitude is understandable as banks are the custodian of funds deposited with them and that their policy is to maximise profits, it is equally important to bear in mind that the Government's objectives be achieved. To strike a balance between the conflicting objectives of maximising profits on the part of the commercial banks and eradicating poverty and restructuring society on the part of the Government, it was proposed that a guarantee body be establised to minimise the risk and to reduce the losses that might be incurred by the commercial banks in providing these loans and advances while at the same time achieve the Government's objectives of providing capital to these entrepreneurs. As lending to this sector of business community would not only benefit the country and the Government as a whole but would ultimately benefit the commercial banks as well since the small entrepreneurs would grow to be big entrepreneurs, it was proposed that the guarantee body be established on a joint-venture basis between the Government and the commercial banks. The credit guarantee body which is the Credit Guarantee Corporation Malaysia

Berhad was therefore established on this joint-venture basis in July 1972 with participation by Bank Negara Malaysia and the commercial banks and started its operation in January 1972.

3.2 Philosophy of the Guarantee Scheme

When the credit guarantee scheme was formulated by the CGC (M) Bhd. in 1972, the first circular dated November 30, 1972 was sent to all commercial banks. Among other things, it was stated that :-

" This Scheme is the first of its kind to be introduced in our country and its primary objective is to enable existing and potential small entrepreneurs to obtain financial assistance for their fixed assets and working capital requirements at a reasonable rate of interest from institutional sources. We however, wish to make it clear at the very outset that the guarantee scheme does not imply any dilution of lending standards in favour of the borrowers. Banks are expected to safeguard fully their own interests and those of the Corporation by taking all possible care in the appraisal of credit applications and the granting and recovery of the credit facilities eligible for guarantee under the Scheme. The Corporation's guarantee is intended to protect the banks against the risk of lending on this basis to small borrowers. We also wish to clarify that guarantee of the Corporation does not in any way diminish the borrower's obligation to repay the credit facilities provided to him, nor is it a substitute for any security which he may be in the position to provide."

The philosophy of the guarantee scheme, for all intents and purposes, is to benefit the small borrowers as well as to minimise the risks of lending of the banking system to the small borrowers. Apart from this, banks must carefully ensure that the eligibility requirements and conditions are satisfied in every case. This may be verified by the bank concerned by independent enquiries, including periodic visits to the borrower's business premises and examination of his books of accounts. It is important to realize that a credit facility will be covered by the guarantee only so long as all the eligibility conditions are satisfied and the lending bank is to exercise the same diligence in recovering the dues in all ways open to it as it might exercise if no guarantee had been furnished by the CGC.

The provisions of the guarantee scheme had since then been amended several times to suit the changing needs of the banking system but the philosophy remains unchanged.

3.3 The Credit Guarantee Corporation (Malaysia) Berhad

The Credit Guarantee Corporation (Malaysia) Berhad was established on a joint-venture basis between Bank Negara Malaysia and the commercial banks in Malaysia on July 5, 1972 and started its operation in January 1973 with an initial issued and paid-up capital of RM 2.6 million and authorised capital of RM 20 million.[1] Its main objective is to provide guarantee cover on commercial loans from financial institutions so as to encourage them

1.Credit Guarantee Corporation (Malaysia) Berhad, July,1994.

to lend to small and medium scale enterprises (SMEs) which have no or inadequate collateral although they might have good ideas, expertise, and initiative.

The first Chairman of CGC was Encik Rastam bin Abdul Hadi (1973). He was replaced by Dato'Abdul Aziz bin Haji Taha in 1974 who resigned in 1980 and was subsequently succeeded by Tan Sri Dato' Dr. Lin See Yan, who was then the Deputy Governor of Bank Negara Malaysia. CGC is governed only by the Companies Act 1965 (Revised 1973) (Act 125). Not only does the Central Bank have the formal control available to shareholders of a company, but it can, by virtue of its banking function, influence the strategy and policy of the CGC. CGC is not the custodian of public funds and it does not lend money itself. It only guarantees credit facilities advanced by the commercial banks. Its liability therefore arises only in the event of the default of the debtor. Yet it takes a risk as it provides the collateral which the borrower himself lacks. The only real security is a thorough evaluation of the project. Since the commercial banks are themselves shareholders of CGC, it is in their interest to forward to CGC only those applications which they regard as feasible projects.

The first scheme introduced in January 1973 was called the Credit Guarantee Corporation (Small Loans) Guarantee Scheme, 1973 or later referred to as the General Guarantee Scheme (GGS). Under the scheme, loans and advances granted by the commercial banks to the small entrepreneurs for working and fixed capital were guaranteed by the CGC up to 60% of the amount of loans and advances in default. For providing this guarantee, a guarantee fee of half of one per cent (0.5%) per annum was levied by the CGC on the amount of loans outstanding per month payable on a monthly basis. The percentage of guarantee cover and the guarantee fee have not been revised since the CGC started its operations but the Credit Guarantee Scheme itself has been revised in October, 1973 firstly to overcome certain legal problems that have been encountered and secondly to remove certain restrictions and simplify certain provisions under the scheme so that it could be implemented easier.

Under the revised scheme, loans and advances for financing any viable productive economic activity which are less than RM100,000 for non-Bumiputras and RM200,000 for Bumiputras would have to be guaranteed by the CGC. Out of the maximum amount of loans and advances provided under the Scheme, loans and advances not exceeding the sum of RM30,000 are not required to be secured , while loans which are in excess of that amount would have to be secured by land and immovable property, or shares, or monies placed in a fixed deposit account with a licensed bank or a licensed borrowing company or any properties that are of value and acceptable as collateral in normal banking practice.

The entrepreneurs that are eligible for the loans and advances mentioned above must be Malaysian citizen carrying out businesses in Malaysia and borrowing only from one bank with an aggregate amount of loans of not more than the maximum stipulated under the Scheme, whether they are one or more individuals, a proprietary or partnership firm, a co-operative society or any other group, association or organisation or a company within the meaning of the Comapnies Act, 1965 , whose paid up capital and reserves should not exceed RM 100,000 for non-Bumiputras and RM 200,000 for Bumiputras.

To complement the GGS, a second scheme known as the Special Loan Scheme (SLS) was introduced in January 1981, seven years after the first scheme was introduced. It had become apparent by that time that there were certain weaknesses in the guidelines, operations and administration of the earlier scheme (GGS) which necessitated the introduction of the SLS. SLS was also introduced with the objective of assisting further the development of Small Scale Enterprises (SSE) in the country.

For some reasons, the GGS was not completely replaced. It was operational until 1989. Bank Negara only set targets for the SLS which was initially based on 5% of the total loans outstanding of the commercial banks as at December 30, 1980. The date was initially set for one year but the compliance date was subsequently extended to December 1985 owing to difficulties encountered by the banks.

Then, in 1990, Bank Negara Malaysia had stipulated in its lending guidelines that the commercial banks as a whole were required to grant at least RM 600 million in loans to SSEs, of which RM 200 million must be in the form of guarantee cover issued by the CGC(M) Berhad under the PGS. Individual quotas were assigned to banks by BNM and the compliance date originally set on March 31, 1990 was subsequently extended to March 31, 1991. All these measures were aimed at meeting the very objective of the Corporation namely to assist the SSEs in gaining ready access to bank credit at reasonable cost.

One important criteria of the SLS is the definition of Small Scale Enterprises. This sets the boundary for qualification under the scheme. A SSE is defined as any registered business with net assets of up to RM 250,000 or in the case of limited companies, shareholders funds not exceeding RM 250,000 with bank borrowings not exeeding RM 250,000. Hence, this scheme increased the loan limits eligible for guarantee[1] as well as broadened the eligible condition. Overall, the SLS recorded a total of 68,676 borrowers and a loan value of RM 1,916.04 million as at December 31, 1989.

In July 1986 the Hawkers and Petty Traders Special Loan Scheme (HPT) was launched. The maximum loan under the HPT was RM 2,000 with a CGC guarantee of 60%. Under the HPT, a total of 11,738 loans valued at RM 24.34 million was guaranteed by CGC. It was replaced by the Loan Fund for Hawkers and Petty Traders (LFHPT) in April 1990. The LFHPT was introduced to enable the trade associations to be actively involved in assisting their members obtain bank loan and also the subsequent repayment and recovery process. The trade associations' involvement was further expanded with the introduction of the Association Special Loan

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1. Under the General Guarantee Scheme, loan limits was at RM 100,000 for non-Bumiputras and RM 200,000 for the Bumiputras.

Scheme (ASLS) in July 1990. Under the ASLS, the associations were exposed to and undertook the basic lending functions of loan processing and management. The LFHPT and the ASLS were operated simultaneously. Both these scheme provided for loans of up to RM 5,000 with a guarantee cover of 100% by CGC. A total of 3,925 loans valued at RM 14.17 million was guaranteed under the LFHPT whereas 5,746 loans worth RM 11.44 million were guaranteed under the ASLS.

These two schemes (LFHPT and ASLS) were revised in November 1992 and December 1992 respectively. The revised scheme are known as the LFHPT '92 and ASLS '92. The revisions were made with the objective of ensuring that hawkers and petty traders have greater access to loans at reasonable rates. The maximum loan amount under these latest scheme was increased to RM 10,000 with CGC's guarantee maintained at 100%. Until the end of June 1994, the LFHPT '92 had made available credit facilities worth RM 15.5 million to 2,713 hawkers and petty traders, whereas the ASLS '92 recorded 397 loans valued at RM 2.31 million.[1]

Overall, the CGC had guaranteed loans valued at RM 67.41 million under all the hawker and petty traders schemes involving a total of 24,519 such borrowers as at end-June 1994.

On April 3, 1989 the Corporation introduced the Principal Guarantee Scheme (PGS). The two earlier schemes (GGS and SLS) were amalgamated into a more comprehensive, simpler, and effective guarantee scheme which matches the needs of the SSEs and the

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1. Credit Guarantee Corporation (Malaysia) Berhad, June, 1994.

commercial banks. With the introduction of the PGS [1], both the GGS and SLS ceased to operate in terms of new applications but outstanding loans under both the old schemes continued to be guaranteed by the Corporation. The PGS basically gave greater emphasis to the provision of bigger loans (up to RM 500,000) without collateral or with inadequate collateral and increased the effective guarantee cover for clean facilities up to a maximum of RM50,000. To encourage the banks to lend under the scheme, the guarantee cover was raised to 70%, and the maximum interest rate for such loans was raised to 1.5% above the Base Lending Rate of the lending institution. Under the PGS, a total of 15,458 loans valued at RM 1,010.2 million was guaranteed by the CGC.

Consistent with new demands and the need for CGC to take on a greater role in the development of SMIs, the PGS was revamped on January 5, 1994 and is now known as the New PGS (NPGS). It provides guarantees on loans of up to RM 5 million with guarantee covers ranging from 70% to 90% depending on the underlying collateral and the type of industry. Industries promoted by the Ministry of International Trade and Industry or Malaysian Industrial Development Authority are considered priority sectors (see Appendix III) and are given priority treatment. Since the NPGS was implemented in mid-February 1994 until end-June 1994, a total of 991 loans valued at RM 141.01 million had

1. One interesting feature of the PGS is that, unlike the GGS and SLS, the PGS allowed participation by professionals, such as doctors, lawyers and practicing accountants.

already been guaranteed. Features of the CGC schemes currently in operation are shown in Appendix IV.

The Malaysian Government launched the ' Tabung Usahawan Baru ' - TUB (New Entrepreneurs Fund) in December 1989 which aimed at assisting the growth of small and medium-sized Bumiputra (indigenous) entrepreneurs in line with the New Economic Policy. Loans under the TUB are funded by the Central Bank at a concessionary rate and the interest rate charged to borrowers is fixed at 5 % per annum. Such loans may be obtained from 12 financial institutions, 10 of which are commercial banks, and as of June 1, 1991, those loans granted through the commercial banks can be guaranteed by CGC under the TUB Guarantee Scheme. As at the end of June 1994, a total of 151 loans worth RM 52.82 million were guaranteed under this scheme.

In October 1992, as part of the Corporation's efforts to channel very small loans to small businesses, particularly to those in the lowest income group in rural and suburban areas, the Corporation entered into an agreement with the 'Amanah Ikhtiar Malaysia' (AIM) whereby the Corporation allocated an initial sum of RM 2 million in the form of a revolving fund to be channeled as loans to AIM's members. As at end-June 1994, loans totalling RM 4.946 million and involving 4,120 borrowers were approved under the AIM-CGC scheme. It is to be noted that the rate of repayments of all loans under this scheme is 100 %. Features of the CGC schemes currently in operation are shown in Appendix IV.

In October 1988, the Corporation became a member of the Asian Credit Supplementation Institution Confederation (ACSIC) [see Appendix I], an association formed by credit guarantee or similar insttutions from nine member countries - Japan, Korea, Nepal, Sri Lanka, Taiwan, the Philippines, Thailand, Indonesia and Malaysia. The objective of ACSIC is to promote the sound development of credit supplementation system for small business in member countries through the exchange of personnel among small business credit supplementation institution in Asia. Credit Guarantee Corporation (M) Berhad's participation in ACSIC will set yet another dimension of its ever evolving role - attracting foreign investors particularly the SSEs in the developed countries such as Japan and Korea to either set up joint- venture companies with the local SSEs or assist in the development of the SSEs in Malaysia.

On June 9, 1994, during the CGC (M) Berhad Annual General Meeting, Resolution 6 and Resolution 8 said that to succeed , the CGC's reorganisation and liberalisation efforts require broad-based support to strengthen its finances. This was done through an injection of RM 100 million by way of :

a) Long term interest free loans of RM 40 million each from Bank Negara Malaysia and the Government;

b) Increase in its paid-up capital by RM 20 million from the existing Rm 2.6 million through :

i. an additional RM 13.2 million to be issued and subscribed by the existing shareholders (the commercial banks), and;

ii. a new share issue of RM 6.8 million to be subscribed by all licensed finance companies.

The amount of capital contribution by each participating financial institution (other than Bank Negara) will be based on the institution's shareholders' funds, with no single institution taking up more than 4.9 % of the expanded paid-up capital of the CGC (RM 22.6 million), which is structured as follows :

Shareholders	Amount (RM)	%
Bank Negara Malaysia	4,520,000	20
Commercial banks	1,300,000	50
Finance companies	6,780,000	30
TOTAL	22,600,000	100

Source : Credit Guarantee (M) Berhad Annual Report (1993)

Hence, overall, the cumulative value of all guaranteed since CGC's inception until the end of June, 1994 amounted to RM 4,103.23 million involving a total of 190,712 borrowers [1]. No doubt, the CGC (M) Berhad 's guarantee schemes had benefitted a very large segment of the small business community throughout the country over the past twenty-one years; they had in practice enabled many small business to gain ready access to institutional credit at reasonable cost.

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1. Credit Guarantee Corporation (Malaysia) Berhad, June 30, 1994.