SECURING FINANCIAL RESOURCES FOR SMALL AND MEDIUM CONTRACTING FIRMS IN MALAYSIA

by

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TABLE OF CONTENTS

LIST OF TABLES

LIST OF TABLES

LIST OF FIGURES

LIST OF ABBREVIATIONS

BA	Banker Acceptance
BLR	Base Lending Rate
BNM	Bank Negara Malaysia
CIDB	Construction Industry Development Board
DFIs	Development Financial Institutions
EXIM	Export-Import Bank of Malaysia Berhad (EXIM)
FSMI 2	Fund for Small and Medium Industries 2
GDP	Gross Domestic Product
LC	Letter of Credit
M&A	Memorandum & Article of Association
MARA	Majlis Amanah Rakyat
NEF 2	New Entrepreneurs Fund 2
NPLs	Non-Performing Loans
PFIs	Private Financing Initiatives
PKK	*Pusat Khidmat Kontraktor*
SMEs	Small and Medium Enterprises
SPSS	Statistical Package for Social Sciences
8MP	Eighth Malaysia Plan
9MP	Ninth Malaysia Plan

MEMPEROLEHI SUMBER KEWANGAN UNTUK FIRMA PEMBINAAN BERSAIZ KECIL DAN SEDERHANA

ABSTRAK

Penyelidik dalam bidang perusahaan kecil dan sederhana (PKS) sering mendalilkan bahawa PKS mempunyai criteria seperti kekurangan modal dan tidak mendapat pembiayaan perkembangan yang setaraf. Kajian ini menyelidiki perbezaan antara pinjaman yang diberikan kepada firma pembinaan bersaiz kecil dan sederhana oleh bank-bank komersil dan agensi-agensi kerajaan. Secara spesifik, ia menyelidik ketersediaan pinjaman yang diberikan oleh bank-bank komersil dan agensi-agensi kerajaan serta ciri-ciri dan prosedur untuk mendapatkan pinjaman tersebut. Selain daripada itu, pinjaman yang digemari dan sebab-sebab pemilihan serta masalah yang dihadapi dalam mendapatkan pinjaman dan pembayaran balik oleh firma pembinaan bersaiz kecil dan sederhana juga ditinjau. Kedua-dua cara iaitu kualitatif dan kuantitatif digunakan untuk dua populasi sampel yang berbeza iaitu pegawai bank dan kontraktor. Data dikumpulkan melalui 3 cara iaitu temuramah (pegawai bank), borang soal selidik (kontraktor) dan data sekunder. Empat agensi kerajaan dan 13 bank komersil telah ditemubual. Soal selidik dihantar kepada 500 firma bersaiz kecil dan sederhana di seluruh Semenanjung Malaysia dan 51 maklumbalas diterima. Kesemua institusi kewangan mempunyai program kewangan tersendiri yang ditawarkan untuk menarik firma pembinaan bersaiz kecil dan sederhana. Kebanyakan responden lebih menggemari bank-bank komersil daripada agensi-agensi kerajaan. Bumiputera-Commerce Bank dan Malayan Banking merupakan dua bank yang paling digemari oleh firma pembinaan bersaiz kecil dan sederhana.

Alasan yang diberikan oleh responden ialah kerjasama yang diberikan oleh pegawai pinjaman, kepantasan dan kecekapan perkhidmatan dan kelulusan permohonan dalam jangka masa yang lebih pendek. Responden yang memilih agensi-agensi kerajaan kerana permintaan cagaran yang lebih longgar dan kadar faedah yang lebih berdaya saing. Lebih daripada separuh responden menghadapi masalah dalam mendapatkan pinjaman daripada kedua-dua institusi. Tempoh pemprosesan pinjaman yang lama merupakan masalah yang paling kerap dihadapi daripada kedua-dua bank komersil dan agensi kerajaan. Responden juga menghadapi masalah dalam menjelaskan pinjaman kerana kelewatan memperolehi bayaran kemajuan kerja daripada klien.

SECURING FINANCIAL RESOURCES FOR SMALL AND MEDIUM CONTRACTING FIRMS IN MALAYSIA

ABSTRACT

Small and medium enterprises (SMEs) researchers often argue that SME are characterised by lack of capital and are unable to access the same kinds of growth funding. It is also indicates that debt capital is the most important capital source for construction firms. This study examines the loan offered by commercial banks and government agencies to small and medium contracting firms. Specifically, it looks into the loan availability offered by commercial banks and government agencies as well as the characteristics and procedures in getting the loan. Additionally, loan preferences and the reasons of preferences as well as the problems faced in obtaining and repaying the loans by the small and medium contracting firms are explored. Both qualitative and quantitative methods were adopted for two different sample populations, i.e. bank officers and contractors. Data was collected and triangulated using interviews (bank officers), postal questionnaires (contractors) and secondary sources. Four government agencies and 13 commercial banks were interviewed. Postal questionnaires were sent out to 500 small and medium contracting firms all over the Peninsular Malaysia, and 51 companies responded. Results showed that all financial institutions have their own financing programmes for the small and medium contracting firms. Majority of the responding companies preferred to loans from commercial banks compared to government agencies. Bumiputera-Commerce Bank and Malayan Banking are the most preferred institutions by the small and medium contracting firms. The reasons are 'cooperative' loan officer, speed and

efficiency of the services and shorter application approval period. Responding companies which opted for government agencies cited flexible collateral requirements followed by competitive interest rates. More than half of the responding companies have problem in obtaining loan from both financial institutions. Delay in loan processing time was cited as the most frequent problem faced from both commercial banks and government agencies. Responding companies faced problem in repaying their loans due to delay in receiving progress payments from clients.

CHAPTER 1: INTRODUCTION

1.1 Background

Small and medium enterprises (SMEs) are the backbone of virtually all economies in the world as they responsible for significant levels of employments, innovation and productivity (Velasco and Cruz, 2001; Klapper et al., 2002 and Svejnar, 2002). A census conducted by the National SME Development Council, whose findings were published in the first *SME Annual Report 2005*, showed there were 518,996 SMEs in Malaysia (SME, 2006). Of the SMEs, services sector (included ICT and construction sector) formed the largest category with 86.5% of total SMEs followed by manufacturing sector, 7.3% and agriculture 6.2%.

Construction industry is one of the most important industries in Malaysia's economy, contributing approximately 4 percent of gross domestic product (GDP) (Ministry of Finance, 2007; CIDB, 2007). Following the Asian Financial Crisis in 1997/98, the Malaysian construction industry has endured lackluster financial performance that is far removed from the sterling performance before the crisis. Though the contribution of the sector shrunk after the financial crisis, the slowdown in the construction industry is expected to reverse with the implementation of the Ninth Malaysia Plan (9MP). The Malaysian government has allocated RM 200 billion for development expenditure in 9MP and another RM 20 billion through Private Financing Initiatives (PFIs). This optimism is reflected in the number of contractors registered with Construction Industry Development Board (CIDB) which has been increasing of late. In 2005, the number of contractors registered with CIDB has grown to more than 70,000 (94% categorized as SMEs) compared to 2001 with only more than 45,000.

With the increased in construction contracts under 9MP, more and more projects can be secured by the contractors.

Previous researchers have examined a variety of issues related to SME lending, including the role and nature of relationship lending (Boot, 2000), the importance of small bank lending to economic growth (Berger et al., 2004), the impact of technology on small business lending (Petersen and Rajan, 2002) and the nature of non-bank-commercial lending (Carey et al., 1998). Many studies also have been done to support the argument or contention about the difficulty of SMEs in getting financing from the financial institutions (Miles and Ward, 1991; Eyiah, 2001; and BNM, 2007).

The role of finance has been viewed as a critical element for development of SMEs (Cook and Nixson, 2000). Based on the study by Jaafar (2004), external financing is the most important capital source for construction firms (small and medium) in Malaysia. Cook and Nixson (2000) concluded that research is needed in the forms of finance used by the SMEs and the availability by the lending institutions.

As for construction industry, only a handful of researches have been carried out on this area. Majority of the studies on SMEs were related to financing on non-construction industries (Hamilton and Fox, 1998; Carey and Flynn, 2005 and Watson, 2006). While on construction industry, previous researchers emphasised more on developing a new framework or model for financing.

1.2 Problem Statement

Although SME form the backbone of the economy, they are unable to access the same kinds of growth funding often available to large businesses (Winborg and Landstrom, 2001). They have been compromised by the chronic and often acute constraints on their access to finance. Information asymmetries associated with lending to small scale borrowers have restricted the flow of finance to smaller enterprises (Cosh and Hughes, 2000). Indeed, many SMEs are characterised by a lack of capital. And access to finance on competitive and realistic terms is a key to their viability and growth (Binks and Ennew, 1996). However, there is very little available data on the type of finances used by SMEs (Cosh and Hughes, 2000).

From a study of 172 small and medium sized construction companies throughout Peninsular Malaysia, Jaafar (2004) found that debt capital has significant relationship with their performance. This indicates that debt capital is the most important capital source for construction firms. The study provided support to McMahon (2001) who found that business growth outcomes and better business performance are highly dependent on external finance.

Governments of many countries try to help their SMEs in financing wherever possible (Mizutani, 1999; Brimble et al., 2002 and Hill, 2002), but the results have generally been poor (Falkena, 2001). Even though SMEs face problem in obtaining loans from commercial banks, still, banks represent an important and indispensable business partner for SMEs (Group of Ten, 2001 and Norton, 2003) including contracting firms (Yaves et al., 2004).

Hence, there is a necessary to look into the two sources of finance for SMEs - government agencies and commercial banks - to find out the difficulties in obtaining loans from both institutions.

1.3 Research Objectives

The aim of this research is to look at the differences between the loans offered by commercial banks and government agencies as well as the loan preference of the small and medium contracting firms. In order to achieve this aim, several objectives were formulated as follows: -

1. To examine loan availability to small and medium contracting firms in Malaysia offered by commercial banks and government agencies.
2. To review the characteristics and procedure taken in getting loan from the commercial banks and government agencies in terms of eligibility, amount of loans, interest rates, processing time, and documentations requirement.
3. To examine the loan preference of the small and medium contracting firms between commercial banks and government agencies, their reasons for the preferences, the problems faced in obtaining and repaying loans from the two sources.

1.4 Research Questions

1. What kind of loans by commercial banks and government agencies are available to small and medium contracting firms in Malaysia?
2. What are the characteristics of, and procedures for obtaining the loan from commercial banks and government agencies?
3. Between government agencies and commercial banks, which is preferred by the small and medium contracting firms, and what are the reasons for the

preference as well as the problems faced in obtaining and repaying loans from the two sources?

1.5 Outline of Research Methodology

The research adopted both qualitative and quantitative method for two different sample populations, i.e. bank officers and contractors. The qualitative method was adopted for banks and government agencies while the quantitative method for small and medium sized contractors. Structured interview was conducted with bank officers while postal questionnaires were posted to small and medium sized contractors' firms all over Malaysia, except Sabah and Sarawak. The research methodology is described in detail in Chapter 4.

1.6 Outline of Thesis

Chapter 1 touches on the background of the research as well as the details of the objectives and purpose of the research. Chapter 2 reviews the literature on banking system in Malaysia. Chapter 3 elaborates on the overview of SMEs and small and medium contracting firms as well as the sources of the financing. Chapter 4 provides details on the design of the study, data collection and types of analyses used in this study. Chapter 5 and 6 present the findings and analysis of the bank officers and small and medium contracting firms respectively. Finally, chapter 7 highlights the summary and recommendations of the future research.

CHAPTER 2: LITERATURE REVIEW

2.1 Introduction

This chapter reviews the banking system in Malaysia. Firstly, this chapter gives an overview of the banking system in Malaysia. Secondly, the chapter focuses on the loan disbursement to the construction industry and lastly on the loan criteria needed to succeed in getting the loan from the banks.

2.2 Overview of Banking System in Malaysia

The central bank of Malaysia, Bank Negara Malaysia (BNM) and the banking industry make up the banking system. BNM is responsible for maintaining monetary stability and ensuring a sound financial system (BNM, 1999). Towards this end, BNM regulates and supervises the Malaysian banking system, selects development finance institutions and insurances companies (BNM, 2007). The banking system, comprising commercial banks, merchant banks and Islamic banks, is the primary mobiliser of funds and the main source of financing to support economic activities in Malaysia. The commercial banks are the main players in the banking system. As at the end of December 2005, there were 10 domestic and 13 locally incorporated foreign commercial banks, operating through a network of 1,963 branches across the country (MIDA, 2004).

Currently, there are 10 merchant banks engaged in the short-term money market and capital raising activities includes underwriting, loans syndications, corporate finances and management advisory services, arranging for the issue and listing of shares as well as investment portfolio management.

There are also six Islamic banks which provide the full range of financial services based on Syariah principles. In addition, eight conventional banks also provide Islamic banking services through a dedicated window.

Malaysia has several development financial institutions (DFIs) which were established and funded by the Government with specific objective to develop and promote strategic economic sectors, such as the manufacturing and exports sectors, SMEs, as well as the agriculture, infrastructure and maritime sectors. These DFIs complement the banking institutions by providing a range of financial and non financial services to support development of the strategic sectors.

2.2.1 Licensed Financial Institutions

List of licensed banking institutions as at 31 December 2005 which consisted of commercial banks, Islamic banks and DFIs are:-

<u>Commercial banks (Locally-owned)</u>

1. Affin Bank Berhad
2. Alliance Bank Malaysia Berhad
3. AmBank (M) Berhad
4. Bumiputra-Commerce Bank Berhad
5. EON Bank Berhad
6. Hong Leong Bank Berhad
7. Malayan Banking Berhad
8. Public Bank Berhad

9. RHB Bank Berhad
10. Southern Bank Berhad

Commercial banks (Foreign-owned)

1. ABN AMRO Bank Berhad
2. Bangkok Bank Berhad
3. Bank of America Malaysia Berhad
4. Bank of China (Malaysia) Berhad
5. Bank of Tokyo-Mitsubishi UFJ (Malaysia) Berhad
6. Citibank Berhad
7. Deutsche Bank (Malaysia) Berhad
8. HSBC Bank Malaysia Berhad
9. J.P. Morgan Chase Bank Berhad
10. OCBC Bank (Malaysia) Berhad
11. Standard Chartered Bank Malaysia Berhad
12. The Bank of Nova Scotia Berhad
13. United Overseas Bank (Malaysia) Berhad

Islamic Banks

1. Bank Islam Malaysia Berhad
2. Bank Muamalat Malaysia Berhad
3. Commerce Tijari Bank Berhad
4. Hong Leong Islamic Bank Berhad
5. Kuwait Finance House (Malaysia) Berhad
6. RHB ISLAMIC Bank Berhad

<u>DFIs (government-controlled banks)</u>

1. *Bank Pembangunan Malaysia Berhad*
2. SME Bank
3. Export-Import Bank of Malaysia Berhad (EXIM)
4. *Bank Kerjasama Rakyat Malaysia Berhad*
5. *Bank Simpanan Nasional*
6. *Bank Pertanian Malaysia*

Before February 1991, base lending rate (BLR) was administratively controlled by BNM. In February 1991, commercial banks were allowed to declare their own individual BLR subject to a ceiling rate. The BLR framework was intended to create a new interest rate regime whereby both deposit rates as well as lending rates would be determined by market forces (BNM, 1999). This is aimed at fostering greater competition among banking institutions and allowing greater flexibility for the banks to pursue their own lending strategies. This means that less efficient banks (bank with higher operating costs) charge higher interest rates on loans (Abreu and Mendes, 2001).

2.3 Loans Disbursement

The commercial banks are the main players in the banking system. They are the largest and most significant providers of funds in the banking system as they control about 75% of banking sector's market share (BNM, 2001).

Commercial banks in Malaysia, especially locally incorporated banks have been involved in financing small businesses since the early days of their establishment.

During that time, because of their expertise and experience, foreign banks were more interested in fulfilling the capital requirements of corporate customers, including large foreign-owned plantations, mines and agency houses. Therefore, domestic banks were set up to fill the gap in the credit market by catering mainly to small companies which were neglected by the foreign banks (Haron, 1990).

Over the years, domestic commercial banks accumulated experience and expertise in the various aspects of banking, until finally they were able to provide services similar to that of the foreign banks. Like many other business entities, profit has always been in the minds of the commercial banks. Thus, it was inevitable that domestic commercial banks soon expanded their horizon and began courting big corporations. The changing trend in domestic commercial banks did not necessarily mean that they were turning their backs on small businesses. However, they were now free to choose the customers to whom they would loan their money. And, it was their prerogative to establish their lending priority sector.

Issues regarding financing have been highlighted as one of the major problems to the contractor. MasterBuilders (2005) has also highlighted that one of the major problems contractors face relates to the low priority accorded to them by financial institutions compared to other sectors. 14 out of 22 commercial banks included 2 Islamic banks have been selected to have an overview on the accessibility of financial facilities and the amount of financing to the construction industry annually from 2001 to 2005 inclusively as these 16 banks are the largest and important group of financial institution in Malaysia. Figure 2.1 shows the total amount of loan to construction industry for year 2001 to 2005. In 2005, the total amount of loans to the construction industry was RM 25.26 billion compared to RM 23.29 billion and RM 21.71 billion in 2004 and 2003 respectively. The total loan given to the construction sector decreased for the first 3 years from 2001 to 2003. But this trend reversed towards the end of 2005.

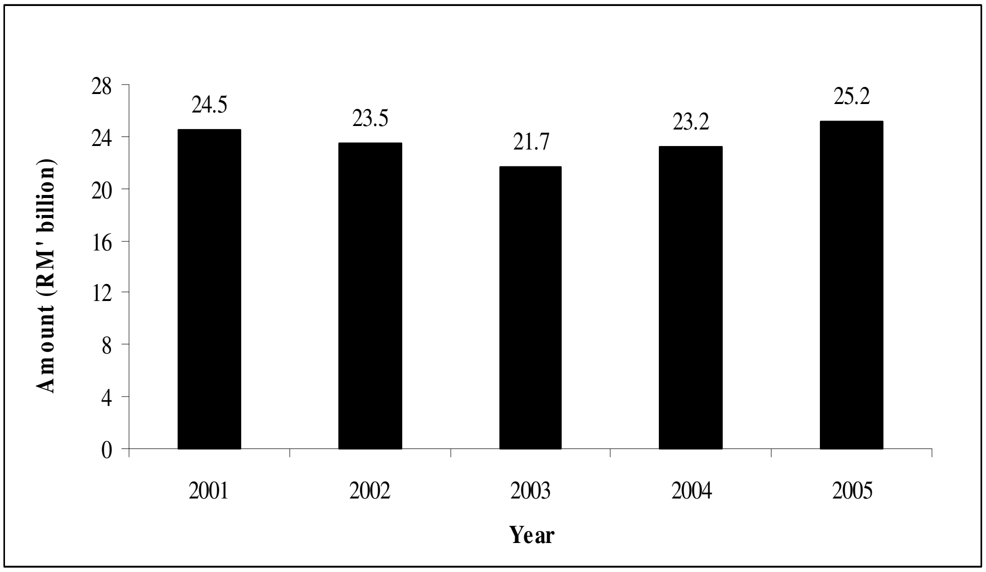
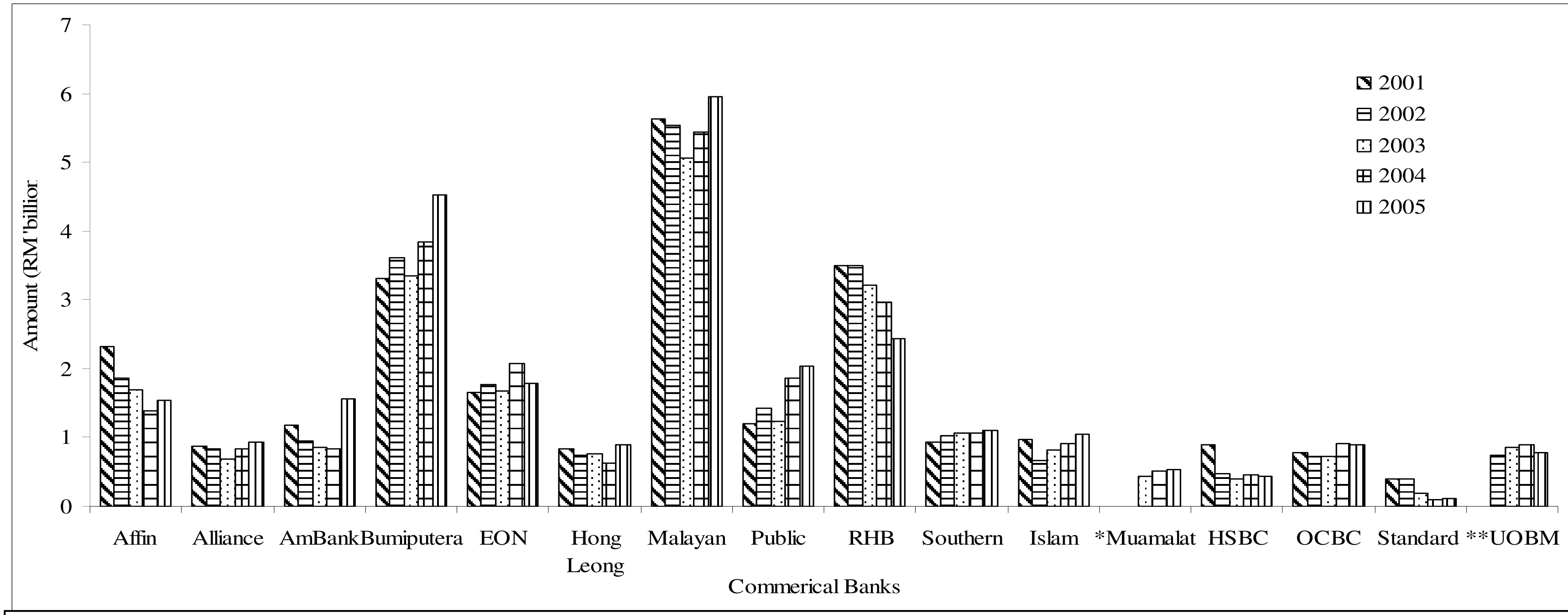


Figure 2.1 Total amount of financing to construction industry (2001-2005) by 14 commercial banks
Source: Yearly Annual Report, 2001 -2005
Note: The statistics exclude United Overseas Bank (Malaysia) Berhad and Bank Muamalat Berhad due to unavailability of information.

Figure 2.2 shows the amount of financing disbursed to the construction sectors by the 16 banks from year 2001 to 2005 inclusively based on their annual reports. The figure shows that Malayan Banking Berhad was the biggest provider of financial facilities to the construction industry with a total of RM 27.61 billion. The second largest financing provider came from Bumiputera-Commerce Bank Berhad with total loan amounting to RM 18.64 billion, followed by RHB Bank Berhad with RM 15.6 billion. For other banks like EON Bank Berhad, Affin Bank Berhad, Public Bank Berhad, AmBank (M) Berhad, Southern Bank, Bank Islam, Alliance Bank

Malaysia and OCBC Bank (Malaysia) Berhad, their total financing facilities varied between RM 1 billion to RM 9 billion. It also shows that the amount of loan annually disbursed to the construction industry by all the 16 commercial banks was inconsistent. For example, the total amount lent to the construction industry increased for 2002 by 9.1% and decrease in year 2003 by 7.5% for Bumiputera-Commerce Bank Berhad while for Malayan Banking Berhad, the amount of loan lent to construction industry decrease for 2002 and further decrease in 2003 by 10.4%.

Apart from that, it also shows that foreign-owned bank were not really interested to lend to the construction industry compared to the locally-owned banks. Total loan disbursed by the foreign banking institutions to the construction industry varied from RM 1 billion to RM 4 billion. While for domestic banking institution, the total loan lent to the construction industry ranged from RM 3 billion to RM 28 billion. This is because foreign banking institutions have generally operated based on a target market, focused on high value corporate clients as oppose to mass consumer and corporate customers for the domestic banking institutions (Haron, 1990; and BNM, 2001).



Total financing for 5 year, 2001 – 2005:

Locally-owned banks

Affin Bank – RM 8.81 billion	Alliance – RM 4.15 billion	AmBank – RM 5.37 billion	Bumiputera – RM 18.64 billion
EON – RM 8.95 billion	Hong Leong – RM 3.87 billion	Malayan – RM 27.61 billion	Public – RM 7.77 billion
RHB – RM 15.64 billion	Southern – RM 5.21 billion	Islam – RM 4.40 billion	*Muamalat – RM 1.48 billion

Foreign-owned banks

HSBC – RM 2.76 billion	OCBC – RM 4.05 billion	Standard – RM 1.19 billion	**UOBM – RM 3.27 billion

Figure 2.2 Amount of financing to construction industry by commercial banks from 2001 to 2005

Source: Yearly Annual Report, 2001-2005

Note: * Exclude 2001 and 2002 annual report

** Exclude 2001 annual report

Table 2.1 shows the total assets of the banks which can be used as a proxy for their size. For many years it has been the practice to measure the size of commercial banks by their total assets, which consist chiefly of loans and investments (United Bank & Trust, 1997). Malayan Banking Berhad was the largest commercial bank in Malaysia followed by Public Bank Berhad and Bumiputera-Commerce Berhad Bank for 2005. However, surprisingly Public Bank Berhad which was the 2nd largest bank in Malaysia only lent RM 7.77 billion (2001-2005) to the construction industry, compared to Malayan Banking Berhad which was the largest bank in Malaysia (RM 27.61 billion). This shows that not every bank was interested in giving loan to construction industry. Statistics suggest that Public Bank favoured other sectors like services and manufacturing when giving out loans. Based on Public Bank's 2005 annual report, the services sector consisted of 13.8% of its loan and manufacturing sector 4.7% whereas for the construction sector, it was only 3.1%.

Table 2.1 The surveyed banks' total assets for 2005

Commercial Banks	**Total Asset (RM'000)**	*** Size**
Domestic		
Malayan Banking Berhad	175,434,713	1
Public Bank Berhad	107,364,902	2
Bumiputera-Commerce Bank Berhad	70,418,921	3
RHB Bank Berhad	70,364,722	4
Hong Leong Bank Berhad	57,675,075	5
AmBank (M) Berhad	38,086,965	6
EON Bank Berhad	35,942,461	8
Southern Bank Berhad	25,089,807	12
Affin Bank Berhad	24,993,405	13
Alliance Bank Malaysia Berhad	21,550,647	14
Bank Islam Malaysia Berhad	15,848,906	15
Bank Muamalat Malaysia Berhad	10,269,647	16
Foreign		
HSBC Bank Malaysia Berhad	36,537,716	7
Standard Chartered Bank Malaysia Berhad	34,908,468	9

Table 2.1 - Continued

Commercial Banks	Total Asset (RM '000)	Size
Foreign		
United Overseas Bank (Malaysia) Berhad	31,054,390	10
OCBC Bank (Malaysia) Berhad	30,804,054	11

Source: Yearly Annual Report 2005
Note: 1-16 represent size of bank from large to small

2.3.1 Non-Performing Loans

It can be observed that many loans become non-performing, which is commonly referred to as uncollectible. Table 2.2 shows the amount of non-performing loans (NPLs) by contractors for 2004 and 2005. For certain banks such as Bumiputera-Commerce Bank Berhad, EON Bank, RHB Bank Berhad and Southern Bank Berhad, NPLs for 2004 were lower compared to 2005. Compared to the domestic banking institutions, the NPLs of foreign banks decreased from 2004 to 2005. This is because the foreign banking institutions have superior supervision imported from their parent country, their expertise in banking and product management (BNM, 2001).

For all the commercial banks, most of the NPLs were around 8% to 30% of the total loans, except for Affin Bank Berhad and AmBank (M) Berhad. For these banks, their NPLs were as high as 37% to 54% for 2004 and 2005, compared to the other commercial banks. Public Bank recorded the lowest NPL in year 2004 while United Overseas Bank (Malaysia) Berhad shows the lowest NPL for year 2005. For both Public Bank and United Overseas Bank (Malaysia) Berhad, their NPLs varied from 1% to 6%. This could be due to their prudency when lending to the construction industry.

Researchers have found that bank efficiency has direct relationship with NPLs (Berg et al., 1992; Hughes and Mester, 1993; Berger and DeYoung, 1997; and Nihon, 2001). For example, loans are turning non-performing loans at a faster pace due to the banks' lax self assessment (Nihon, 2001). According to Nihon (2001), the increase in NPLs can also be due to the increase in bankruptcy. Statistics for year 2001 shows that, in Malaysia, the majority of the bankruptcies were contracting firms (Jaafar, 2003) and the number of the bankruptcies was increasing yearly (Insolvency Department, 2006). In Malaysia, the current scenario in contractor registration leads to stiff competition and over-capacity. With low value-added activities in the construction industry, the number of bankruptcies of contracting firms is bound to increase. Furthermore, the small contribution to GDP by the sector due to the highly competitive market conditions, rising cost of building materials and low construction technology adoption by the industry is likely to worsen the scenario (Abd. Karib, 2006).

Table 2.2 Amount of NPLs to banks by construction industry for 2004 and 2005

Commercial Banks	2004			2005		
	Loan (RM'000)	NPL (RM'000)	%	Loan (RM'000)	NPL (RM'000)	%
Domestic						
Affin Bank Berhad	1,388,195	638,351	45.98	1,539,131	578,487	37.58
Alliance Bank Malaysia Berhad *	832,016	n/a	n/a	923,763	126,880	13.73
AmBank (M) Berhad *	845,141	n/a	n/a	1,551,835	834,620	53.78
Bumiputera-Commerce Bank Berhad	3,837,234	337,018	8.78	4,531,916	478,991	10.57
EON Bank Berhad	2,064,816	222,860	10.79	1,782,588	250,672	14.06
Hong Leong Bank Berhad	630,179	n/a	n/a	901,480	264,969	29.39
Malayan Banking Berhad **	5,437,549	n/a	n/a	5,950,597	822,449	13.82
Public Bank Berhad	1,867,005	90,226	4.83	2,039,666	52,165	2.57

Table 2.2 - Continued

Commercial Banks	2004			2005		
	Loan (RM'000)	NPL (RM'000)	%	Loan (RM'000)	NPL (RM'000)	%
Domestic						
RHB Bank Berhad	2,969,380	676,074	22.77	2,435,838	633,919	26.02
Southern Bank Berhad	1,072,768	76,535	7.13	1,112,725	95,500	8.58
Bank Islam Malaysia Berhad **	904,120	332,455	36.77	1,055,851	335,276	31.75
Bank Muamalat Malaysia Berhad	510, 755	52, 383	10.26	533,616	35,242	6.60
Foreign						
HSBC Bank Malaysia Berhad	457,594	57,149	12.49	428,685	31,718	7.40
OCBC Bank (Malaysia) Berhad	909,047	143,305	15.76	896,770	114,670	12.78
Standard Chartered Bank Malaysia Berhad	86,128	22,416	26.02	122,164	13,881	11.36
United Overseas Bank (Malaysia) Berhad	886,927	54,513	6.15	779,883	11,889	1.52
TOTAL	**24,698,854**	**2,703,285**		**26,586,508**	**4,681,328**	

Source: Annual report 2004 and 2005
Note: * Financial statement ended on 31 March
** Financial statement ended on 30 June

2.4 Loan Criteria

Like all commercial bankers in the world, Malaysian bankers will definitely give loans to the profitable or potentially profitable businesses, since lending is the core activity of a banks and it is its duty to ensure that all monies lent out are collectible. As such, banks will need to assess the creditworthiness of its borrowers to ensure that loans will be repaid through the information provided to the banks (Mohd Harif and Md. Zali, 2006).

In Malaysia, under normal circumstances, every customer who comes to the bank for a business loan need to go through several stages. The first stage is that the banker requests basic documents such as 3-years financial statement, bank statement and also business plan. Then, the banker arranges an interview with the potential borrower to know better about the customer, and lastly makes an evaluation with the information gathered from the borrowers to determine whether the customer is eligible or not for the financing.

Mohd Harif and Md Zali (2006) have concluded that there are 15 success factors in getting business financing for SMEs in Malaysia, seven are core factors and eight supplement factors. Figure 2.3 summarises the success factors for the SMEs business financing.

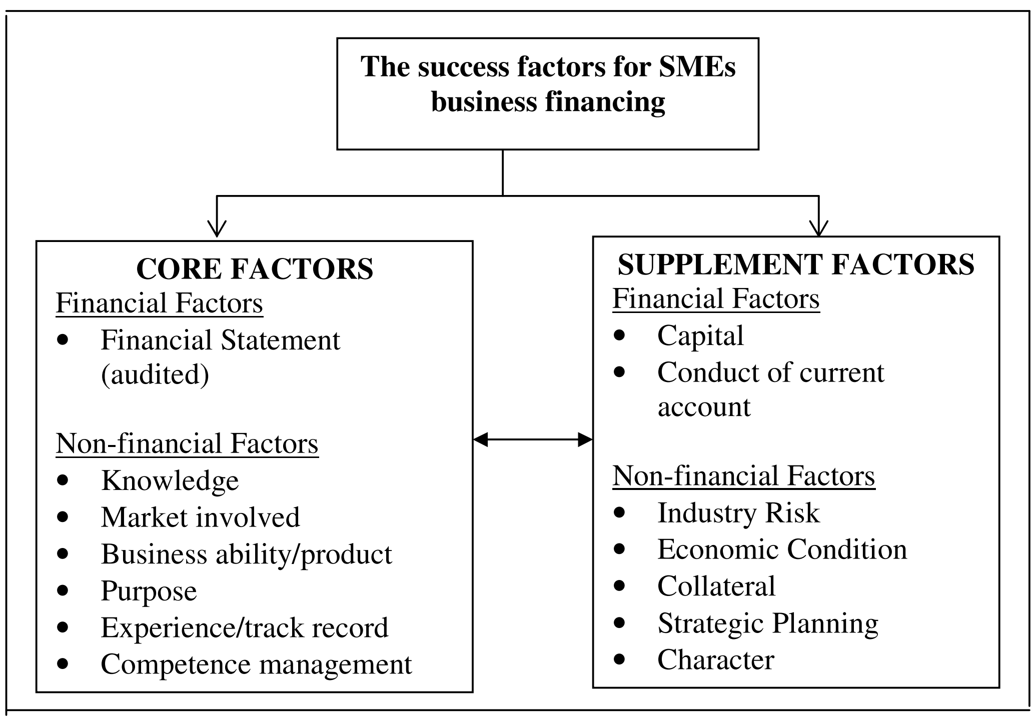


Figure 2.3 The success factors for SMEs business financing
Source: Mohd Harif and Md. Zali, 2006

The financial core factor considered by banks when evaluating the business loan is audited financial statement. This financial statement used is the audited financial statement for the incorporate company because this financial statement contains both qualitative information (e.g. the auditors' report and chairman's statement) and quantitative information (e.g. balance sheet) of the business (Berry et al., 1993).

While the non-financial core factor is knowledge. Knowledge refers to the information gathered by the bankers about the applicant's business (Mohd Harif and Md. Zali, 2006). This knowledge greatly helps a banker in assessing risk associated with lending proposal.

Another identified non-financial core factor is market involved. The market involved means how far the products produced by the borrowers can establish and compete with others products in the markets.

The third factor is business ability. The business ability refers to the ability of applicant to generate enough cash, in the form of cash flow, to repay the loan. The borrowers have only three sources to draw upon to repay their loan, which are cash flow generated from sales or income; the sale or liquidity of assets or fund raised by issuing debt or equity securities. The fourth identified factor is purpose. The purpose of the loan is a significant variable in the lending decision because the loan raised is influential in assessing the potential risk involved in the lending decision (Berry et al., 1993).

The next factor is the experience or track record. Track record is the past experience of the borrower's business and pertains to number of years spent in the industry, other commercial experience, training, etc. (Mohd Harif and Md. Zali, 2006). The last non-financial factor is competent management. In reality the success or failure of business depends upon the skills of the management team. Banks must have confidence that the firm has good management before a loan is granted.

Supplement financial factor include capital and conduct of current account. Capital represents the borrower's money that he puts into a project. It indicates the financial worth of the borrower, and also reflects the accumulated wealth of the borrower, and to some degree an indication of past success. The conduct of current account shows the applicant's ability in managing and using the facilities provide by the banks.

Non-financial factor also includes industry risk. Risk is a term that describes the uncertainty of future outcomes. Banks place great emphasis on conditions in the industry, the applicant's competitive position and relative stability. Industry risk also relates to the trends of industry, including technological changes, new processes and changes in customer demands. The next factor is economic condition. Economic conditions affect the ability of the borrower to repay financial obligations but are beyond the control of the borrower and the lender. The other factor is collateral. Collateral refers to any assets which borrower may have to charge or pledge as security against the loan. Collateral is important because it reduces the credit risk.

The third last factor is planning. Business planning relates to strategic planning. Strategic planning is a long-term overall plan for a business. Strategic planning is concerned with establishing company priorities and resources allocations to meet the strategic goals. The second last factor is character. Character assessment is performed to determine the willingness and desire of borrowers to repay the debt (Mohd Nasir et al., 1998). The borrower's attitude such as honesty, integrity, industry and morality are considered in character assessment. However, a study conducted by Haron (1990) found that domestic commercial bankers regard character as the most important factor in their credit analysis.

The last factor is capacity. Capacity is defined as the legal status of the borrower to enter into contract (Reed and Gill, 1989), whether a borrower has the authority to borrow on behalf of his firm or business. Capacity may also refer to the repayment capability of the borrower (Mohd Nasir et al., 1988).

2.5 Conclusion

As observed from the total amount disbursed, the construction industry is highly dependent on the bank to complete construction projects. However, many loan disburse to the industry had become non-performing. Of the success factors in getting loan by SMEs, financial statement is the most important.

CHAPTER 3: SMALL AND MEDIUM CONTRACTING FIRMS

3.1 Introduction

This chapter reviews the literature on SMEs and small and medium contracting firms. The chapter begins by presenting an overview of SMEs around the world and Malaysia. It then elaborates on the construction industry in Malaysia as well as the definition of the small and medium contracting firms. Lastly, the chapter discusses about the sources of the financing to the SMEs, specifically construction industry.

3.2 Overview of SMEs

Over the last two decades in particular, growth of SMEs have received considerable attention from researchers and policy-makers around the world (Turok, 1991). This is because SMEs play an increasingly important role in a country's economy and have been considered the engine of the economic growth by virtue of their sheer number and significant economic (Asian Development Bank, 2002; Wattanapruttipaisan, 2003; and BNM, 2007).

For example, the United Kingdom boasts around 3.7 million small businesses, which employ half of the workforce and provide over 44 percent to the country's GDP (Bink and Ennew, 1998). It has been highlighted that 99.8% of the 17.9 million enterprises in the European Union are SMEs (Euromoney, 2002), contributing one half of the total value added and two thirds of the domestic workforce (European Union, 2002). Besides that, SMEs also contribute greatly to the United State economy, producing between 40 to 60 percent of the workforce, (Neubauer and Lank, 1998).

Scenario in which economic, financial and developmental growth has been led by SMEs has been seen in many East Asian countries also (Hapitan, 2005). In countries such as South Korea, Taiwan and Indonesia, SMEs number and contribution to total employment in the economies are well over 95% and 70% respectively (RAM Consultancy, 2005). Nugent and Yhee (2002), in studying Korean SMEs, noted the dynamism of SMEs that have contributed to the enormous transformation of the economy. While in Taiwan, Aw (2002) observed that two features characterized Taiwan's 8% per year growth for three decades in early 60s to the early 90s: an export-oriented trade regime and a market structure based predominantly on SMEs.

The SME sectors in Malaysia also play a significant role in the national economy. The sector's contributions to the nation's economy can be seen from various aspects such as in terms of business units, employment opportunities as well as economic output (Hashim, 2000). The Census on Establishment and Enterprises conducted in 2005 shows that there are 581,996 SMEs, representing 99.2% of the total business establishments in Malaysia (SME, 2006).

Table 3.1 shows a snapshot view of the SME sector in Malaysia and selected countries for comparison. As there is likely difference in the definition of SMEs, it is important to note that Malaysia's position mirrors other economies. In terms of SMEs as a percentage of the total establishments, as in most others in the global economy, SMEs accounts for around 99% of the total establishments with the profile of SMEs in Malaysia not differing much from other countries (BNM, 2007).

Table 3.1 Snapshot view of the SME sector in Malaysia and selected countries

Country	Measures used in the definitions of SMEs	% of total establishment	% of total workforce	% of SMEs' contribution to GDP/ total value-added (*)
Malaysia[1]	Employment and sales	99.2	65.1	47.3*
Japan[2]	Employment and assets	99.7	70.2	55.3
Taiwan[3]	Employment, sales and capital	97.8	77.2	n.a
Korea[4]	Employment and assets	99.8	86.7	50.0*
Thailand[5]	Employments and fixed assets	99.6	69.0	38.9
Singapore[6]	Employment and fixed assets	91.5	51.8	34.7*
Germany[7]	Employment and sales	99.7	79.0	57.0[a]
Indonesia[8]	Assets and sales	99.9	99.6	57.0
China[9]	Employment, sales and assets	99.0	69.7	60.0*
Philippines[10]	Employment and assets	99.6	69.1	32.0*

Sources : [1] - CENSUS 2005
[2] - JASME Annual Report 2004-2005, JASME (http://www.jasme.go.jp)
- APEC – SME Profile (http://www.actetsme.org)
- A Comprehensive Framework for the Development of SMEs in Malaysia, (BNM '03)
[3] - White Paper on SMEs in Taiwan 2005, SMEA (http://www.moeasmea.gov.tw)
[4] - Korean SMEs (2002), SMBA (http://www.actetsme.org)
[5] - White Paper on SMEs in Thailand 2002, OSMEP (http://www.sme.go.th)
[6] - APEC – SME profile (http://www.actetsme.org)
[7] - SMEs in Germany – Facts and Figures 2004 ; and
- Mittelstand – Definition and Key Figures (2003),
- IfM Bonn (http://www.ifm-bonn.org)
- A Comprehensive Framework for the Development of SMEs in Malaysia, (BNM '03)
[8] - APEC – SME Profile (http://www.actetsme.org)
[9] - APEC – SME Profile (http://www.actetsme.org)
[10] - National SME Development Agenda (NSO – 2000/01),
- DTI (http://www.dti.gov.ph)
- APEC – SME Profile (http://www.actetsme.org)

(BNM, 2007)
Note: a – Gross National Product (GNP)