

## PROPOSED INTEGRATED CASH WAQF INVESTMENT MODEL FOR MICRO ENTERPRISES IN MALAYSIA: AN EMPIRICAL ANALYSIS

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### Abstract

Micro Enterprises (MEs) in Malaysia becomes as an important engine for economic growth. Despite its importance and the continuous support from the government, MEs in Malaysia are facing some problems. Several earlier studies stated that Malaysian MEs face the problem of accessing finance due to many factors. Malaysian government has introduced and continued to assist Small and Medium Enterprises (SMEs) through the implementation of several policies, programmes and extensive financial resources allocations to enhance the activities of SMEs. However, these efforts have not been adequate to meet the needs of micro enterprises. The objectives of this study are: 1. To discuss the extent of the problems of (i) financing, (ii) human capital (iii) market accessibility (iv) innovation and technology adoption, and (v) infrastructure development faced by MEs in Malaysia. 2. To develop an alternative model that is available for effectively addressing the problems mentioned in (1) and 3. To analyze the probability that MEs will adopt the proposed model (cash *waqf* investment model). In methodology, primary data are collected using self-developed questionnaire (survey) This study focuses on MEs in Klang Valley (Selangor and Kuala Lumpur) since it records the highest number of such enterprises in the area. The analysis is conducted using statistical analysis and Logistic Regression analysis. The study finds that high probability of MEs opting for the proposed Integrated Cash Waqf model for their business financing is contributed by the high business annual turnovers, older entrepreneurs, those who have more awareness on cash *waqf* and those who have experienced applying loan recently.

Keywords: Micro Enterprises, Cash *Waqf*, Logistic Regression, Malaysia

## INTRODUCTION

Micro Enterprises (MEs) in Malaysia becomes as an important engine for economic growth. They account for a substantial share of total SMEs (Small and Medium Enterprises), employment and gross domestic product (GDP). Indeed, they are contributing significantly to the poverty alleviation in the country. MEs in Malaysia are defined as the establishment with less than five employees or less than RM 300,000 of the sales turnover for manufacturing sectors and RM300,000 for other sectors namely agriculture, mining, quarrying, construction and services<sup>1</sup>. MEs in Malaysia constitute 77 percent of total SMEs in Malaysia along with small and medium enterprises with 20 percent and 3 percent, respectively (Economic Census: Profile of SMEs, 2011). Among the sectors, the bulk of the services sector is micro establishments, representing over 79.0 per cent of total SMEs. The manufacturing and agriculture sectors are with 57.1 per cent and 56.3 per cent, respectively, while the construction sector forms about 45 percent (Economic Census: Profile of SMEs, 2011). Malaysian government has introduced and continued to assist SMEs through the implementation of several policies, programmes and extensive financial resources allocations to enhance the activities of SMEs. For example, in 2004, the National SME Development Council of Malaysia (NSDC) was reinforced to formulate the strategies for the development of SMEs and coordinate the policies and programmes across more than 15 Ministries and 60 Agencies (SME Annual Report, 2010/2011). In addition, in July 2012, the Malaysian government also released the SME Masterplan (2012-2020) which is aimed at becoming the policy direction for SMEs and MEs until the year 2020 to further accelerating growth through productivity gains and innovation.

Despite its importance and the continuous support from the government, MEs in Malaysia are still facing some problems. Several earlier studies stated that Malaysian MEs face the problem of accessing finance due to many factors. Many MEs find difficulties in accessing external financing as they are perceived as a high-risk and a high cost-service market segment (Duc et. al, 2008; Vos et. al, 2007). The requirement of collateral, high cost of financing, difficulty in providing business information, business transaction records and business plans are among the factors that also prevent them from accessing financing (Aris, 2006; Carpenter & Peterson, 2002). Several studies

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<sup>1</sup> The definition of MEs follows the definition developed by the National SME Development Council (NSDC).

on Malaysian MEs have discussed these obstacles of accessing finance such as Hashim (1999); Ting (2004); Saleh and Ndubisi (2006); Abdullah and Mannan (2010); SME Annual Report (2011/2012); and SME Masterplan (2012-2020).

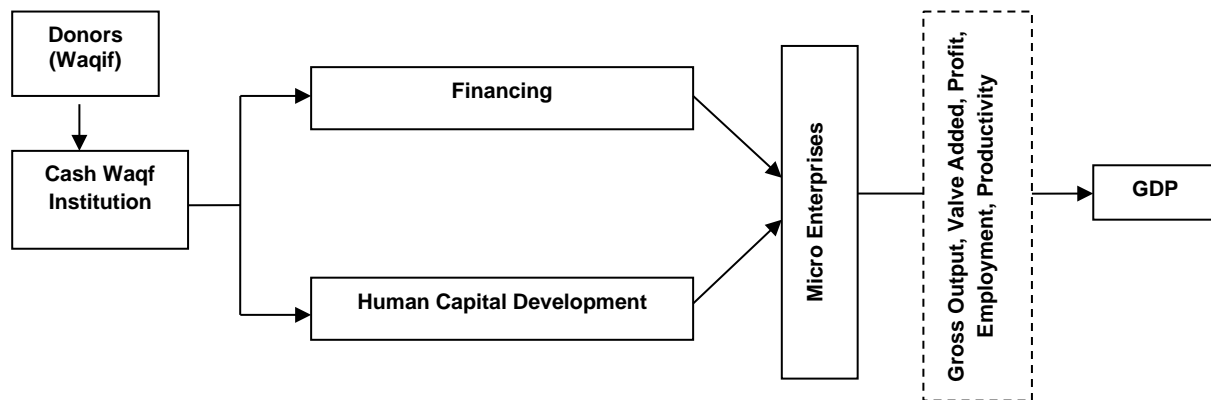
Thus, the objectives of this study are: 1. To discuss the extent of the problems of (i) financing, (ii) human capital (iii) market accessibility (iv) innovation and technology adoption, and (v) infrastructure development faced by MEs in Malaysia. 2. To develop an alternative model that is available for effectively addressing the problems mentioned in (1) and 3. To analyze the probability that MEs will adopt the proposed model (Integrated Cash *Waqf* Investment Model). The remainder of this paper is organized as follows. Section 2 discusses on data collection and methods of analysis. Section 3 discusses on the results and their policy implication. Section 4 then concludes.

## **DATA AND METHODOLOGY**

The study firstly aims to develop a conceptual model of Integrated Cash *Waqf* Investment Model. This study focuses on Cash *Waqf* due to its suitability for financing and human capital development especially for MEs. Cash *Waqf* means “the devotion of an amount of money by a founder and the dedication of its usufruct in perpetuity to the prescript purposes” (Mohsin, 2008). In this case, the donor endowed Cash *Waqf* instead of real estate or fixed asset. The use of Cash *Waqf* comes into the field in eight century after Imam Zufar had approved its use (Toroman et.al, 2007; Cizakza, 2004). Based on his view, Cash *Waqf* can be invested through partnership basis and the profits generated would be spent for the charity purposes. Various suggestions and models of Cash *Waqf* were initiated by scholars. One of the suggestions that arose is that to integrate Cash *Waqf* into the enterprises for supporting their financing and human capital development. Many studies have found that Cash *Waqf* as the most potential source in providing finance and enhance human capital development both in the short and long run. A good number of studies stressed on the utilization of Cash *Waqf* for financing for enterprises particularly micro enterprises (Elgari, 2004; Cizakca, 2004; Dusuki 2008; Hasan, 2010). According to these studies, the proper utilization of *Waqf* mechanism as a source of financing can play the role in providing sufficient fund to the micro entrepreneurs.

In the present study, it tries to integrate Cash *Waqf* with micro enterprises to support them in terms of source of financing. This model is known as Integrated Cash *Waqf* Investment Model. The model is validated its suitability in the market by interviewing the experts from the field. From previous literature on Cash *Waqf*, it is claimed that the Cash *Waqf* can be used to support the financing and human capital development of micro enterprises. Due to this initiative, this research proposes the use of Cash *Waqf* which later integrated into micro enterprise investment model. It is called Integrated Cash *Waqf* Investment Model as illustrated in Figure 1. This model is proposed as an alternative option for the existing micro enterprises schemes of financing and human capital development in Malaysia. This proposed model aims to be a kind of collaborative venture between parties involved. The most important components of this model are the ‘Cash *Waqf* Institution’ and ‘micro enterprises’ with no intermediaries.

**Figure 1: Integrated Cash *Waqf* Investment Model**



This alternative model should be able to (i) provide financial services and sustainable access to credit at a low cost, taking into consideration the risky nature of the micro enterprises and (ii) provide non-financial services to support human capital development for micro enterprises through providing extensive training and skills development, counseling and education to the micro entrepreneurs with the aim to upgrade and enhance their human capital capacity.

Secondly, primary data are collected using self-developed questionnaire (survey) which containing items of different formats. The formats include dichotomous answers such as “Yes” and “No” and self-assessment items measured by *Likert* scale. In addition, the demographic questions also will be covered and it provides information regarding micro entrepreneurs’ business profile, gender,

education level, income level and employment. This study focuses on MEs in Klang Valley (Selangor and Kuala Lumpur). The area is chosen as the database for SMEs including MEs recorded the highest number of such enterprises in the said area. This study applies most widely used formula for sample size. This formula is provided by Yamane (1967) which is given as:

$$n = \frac{N}{1+N(e)^2}$$

where  $n$  is the desired sample size,  $N$  is the population size and  $e$  is the level of precision or sampling error (sampling error in this study is 5%). Thus, the sample size is equal to:

$$n = \frac{N}{1 + N(e)^2} = \frac{77904}{1 + 77904(0.05)^2} = 398$$

By taking the formula, “ $n$ ” which is the desired sample size required for this study is only 398. It is calculated with 95% confidence level and 5% error level. However, for this study, a total of 420 respondents participate in the survey. Only 400 questionnaires i.e. 95.24 percent are usable. The remaining 20 (4.76 percent) questionnaires are not fully completed and excluded from the analysis. The analysis is conducted using Logistic Regression. This is a nonlinear regression model specifically designed for binary dependent variables. The purpose of this model is to test the probability that demographic and banking service factors (variables) contributes to competition awareness among respondents. Unlike linear probability model, this model adopts a nonlinear formulation that forces the predicted values to be between 0 and 1 by using cumulative probability distribution function (c.d.f.) which is denoted by  $F$ . Apart from using logit regression, probit regression could also be used in modeling binary dependent variables. The difference between logit and probit regressions is that probit regression uses the standard normal c.d.f. and logit regression uses the “logistic” c.d.f.<sup>2</sup>. The logistic cumulative distribution function has a specific functional form, defined in terms of the exponential function. The population logit model of the binary dependent variable  $Y$  with multiple regressors could be expressed as:

$$\Pr(Y = 1|X_1, X_2, \dots) = F(\beta_0 + \beta_1 X_1 + \beta_2 X_2 + \dots + \beta_k X_k) = \frac{1}{1 + e^{-(\beta_0 + \beta_1 X_1 + \beta_2 X_2 + \dots + \beta_k X_k)}} \quad (1)$$

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<sup>2</sup> Refer to Stock and Watson (2007) for detail explanation.

The main reason for using logit regression is that the logistic c.d.f. could be computed faster than the normal c.d.f. (Stock and Watson, 2007). Logistic regression model is estimated to predict a categorical (usually dichotomous) variable from a set of predictor variables. For the purpose of this study, the dependent or the outcome variable of interest was constructed as a ‘yes/no’ (later on coded as 1=yes and 0=no) dichotomous indicator based on the response to survey questionnaire item number 22: “Would you willing to use Integrated Cash *Waqf* Investment Model in your business if it is available and used to assist your business in terms of providing financing and human capital development?” Respondents who answered ‘yes’ is coded as 1 and those who answer ‘no’ is coded as 0.

For predictor variables, among the variables included are gender, age, marital status, education level, number of years in business, estimated average annual turnover, number of employee (firm’s size), applying external financing in the last 6 months or a year, difficulty to raise external financing due to business characteristics, high cost or fees of training courses, awareness of Cash *Waqf*, knowledge on Cash *Waqf*. All predictors are dummy variables with two categories. To simplify, we develop a Logit Model as follows:

$$L_i = \ln\left(\frac{P_i}{1 - P_i}\right) = \beta_0 + \beta_1(\text{DEMOGRAPHIC\_VARIABLES})_i + \beta_2(\text{FINANCING \& HMNCAPITAL\_VARIABLES})_i + \nu_i \quad (2)$$

where  $L_i$  is a dummy variable with value of 0 or 1.  $L_i = 0$ , if there is competition awareness and  $L_i = 1$  if there is no competition awareness. In the model (equation 2), if we take the antilog of the  $j$ th slope coefficients ( $\beta$ ’s), subtract one from it, and multiply the result by 100, we will obtain the *percent change* in the odds for a unit increase in the  $j$ th regressor. The percentage change could be interpreted as probability that the opt for the model will change (increase or decrease) due to a unit increase in independent variables such as demographic and other independent variables. It is also important to note that the  $R^2$  is a poor measure of fit for the linear and nonlinear probability model (Stock and Watson, 2007). Therefore, we use another measure of fit for this model of binary dependent variable, namely “fraction correctly predicted”. Besides, we will also perform Pearson  $\chi^2$ -type tests of goodness-of-fit, namely Hosmer-Lemeshow (1989) and Andrews (1988a, 1988b).

## RESULTS AND DISCUSSION

## Descriptive Analysis

As depicted in Table 1, 66 percent of the respondents are male while 34 percent are female. Almost three-quarters (72 percent) of the respondents are between the age group of 20-40, few are over 40 years of age (28 percent). Almost 67 percent of the respondents are married. In terms of educational level, majority of respondents are well educated, with almost 28.7 percent holding a college diploma or matriculation and about 27 percent holding at least a bachelor degree or above. On the other hand, 44.3 percent of the remaining respondents completed primary or secondary school. Table 2 shows that the majority of the respondents (63.3 percent) have been operating their business for 0-5 years, which can be considered as young firms. Majority of the respondents [387 (96.5 percent)] are engaged in the services sector followed by agricultural sector [8 (2 percent)]. The remaining 4 (1 percent) and 2 (0.5 percent) are in manufacturing and construction sectors, respectively. Furthermore, as depicted in Table 2, majority of respondents (56.3 percent) are in the RM10,000-RM50,000 annual sales turnover group. The remaining 43.7 percent of the surveyed respondents fall in the above RM 50,000 annual sales turnover group. It is also identified that 88.5 percent are having 1-5 employee and 11.5 percent are with 6-10 employee.

**Table 1: Distribution of Respondents by Gender, Age, Marital Status and Education level**

		<b>Frequency</b>	<b>Percent</b>
Gender	Male	264	66
	Female	136	34
Age Group	20-30	148	37
	31-40	140	35
	41-50	69	17.3
	Above 50	43	10.8
	Marital Status	Single	117
	Married	267	66.8
	Divorced	16	4
Education Level	Primary/Secondary School	177	44.3
	College Diploma/Matriculation	115	28.7
	Bachelor	83	20.7
	Postgraduate (Master or PhD)	25	6.2

**Table 2: Distribution of Respondents by Business Characteristics**

		<b>Frequency</b>	<b>Percent</b>
No Of Years In Business	0-5 Years	253	63.3
	6-10 Years	101	25.2
	>10 Years	46	11.5

Sector	Services	387	96.75
	Agriculture	7	1.8
	Manufacturing	4	1
	Construction	2	0.5
Annual Turnover	RM10,000-RM50,000	225	56.25
	RM51,000-RM100,000	113	28.3
	RM100,001-150,000	31	7.8
	RM150,001-RM200,000	25	6.3
	RM200,001-RM300,000	6	1.5
No Of Employee	1-5	354	88.5
	6-10	46	11.5

Most of the respondents used internally generated funding (personal & family/relative/friend) to start their business. For example, (76.8 percent or 307) used personal saving to commence their business as shown in Table 3. Meanwhile, 75.3 percent of respondents primarily used financing from family, friends and relatives. Furthermore, 10.7 percent of them had obtained funding from commercial bank while 6 percent get funding from government loan. The remaining 4.7 percent of the respondents indicate that they are being financed by micro finance institutions to start the business.

**Table 3: Source of Financing**

		Yes	No	Total
Personal	N	307	93	400
	%	76.8	23.2	
Family/Relative/Friend	N	301	99	400
	%	75.3	24.7	
Commercial Bank	N	43	357	400
	%	10.7	89.3	
Government Loan	N	24	376	400
	%	6	94	
Microfinance	N	19	381	400
	%	4.7	95.3	

Although micro enterprises may succeed in raising external finance, they mostly encounter problems in the process of obtaining loan. Hence, the respondents were asked about the difficulties in the process of applying and obtaining external finance for the last six months to one year. The respondents indicated that they had faced some difficulties in the process of obtaining finance. Table 4 shows the difficulties that take place during the process of applying external finance. About 74 percent of respondents mentioned higher interest rate as one of the difficulties in obtaining



external finance. Several commercial banks such as Agro Bank Malaysia, Maybank Malaysia, Public Bank Malaysia and SME Bank of Malaysia offer micro financing scheme at the rate range from 5 percent to 15 percent while micro finance institutions such as Amanah Ikhtiar Malaysia (AIM) offered financing at 10 percent and TEKUN at 7 percent.

**Table 4: Type of Problems during Raising Loan**

		Yes	No	Total
High Interest Rate	N	296	104	400
	%	73.8	26.2	
Strict Documentation Requirement	N	307	93	400
	%	76.6	23.4	
Strict Collateral Requirement	N	316	84	400
	%	78.8	20.2	
Insufficient Of Amount Of Financing	N	320	74	400
	%	79.8	20.2	
Long Loan Durations	N	325	75	400
	%	81.3	18.7	
Characteristics Of Business	N	328	72	400
	%	82	18	

Majority of the respondents also agreed that strict documentation requirement and collateral requirement were the obstacles in obtaining external finance. These two factors scored percentage of 76.6 percent and 78.8 percent of respondents agreement, respectively. It seems possible that these results are due to the obligation of the financial institutions to impose several requirements and demand several documentations before granting the loan. It is also to compensate to the nature of micro enterprises that are always perceived as risky businesses. The documents such as business license, business registration, income tax return of the business, (J) Form of proprietor, statement of loans repayment, business and cash flow projection are some of documents that are required by financial institution in Malaysia before granting the loan to the enterprises. Among the common type of collaterals required by the financial institutions in Malaysia are fixed deposits or savings, third party guarantor, and transfer of salary/income to respective banks account. From the survey analysis, 79.8 percent of respondents disclosed that they faced the problem of insufficient amount of financing from financial institutions. The banks may offer amount of loan depending on the size of the businesses, the needs of their respective loan clients and the viability of the micro entrepreneur's businesses.

The other obstacles, such as long term loan duration (81.3 percent) and characteristics of business (82 percent) also can be seen to put undue pressure on a micro enterprise to obtain finance. In many cases, it is found that financial institutions take long time for processing of the loan application even after taking the positive credit decision. The financial institutions often view micro enterprises as a greater risk borrower compared to larger enterprise. Thus, before granting the loan, the banks carry out critical evaluation regarding the characteristics of the businesses which include age of businesses, size of business and viability of the businesses. For the characteristics of the firm, Storey (1994), Sahlman (1990), Agarwal and Audretsch (1999) and Sutton (1997) agreed that firm age and size become the important factors for accessing external financing. For the financial institutions, the likelihood of failure among micro enterprises is clearly higher than their larger counterparts.

### Empirical Analysis

Table 5 shows the logistic regression coefficients based on equation (2), Wald tests and odds ratio for each of the predictors. The odds ratio is abbreviated as  $Exp(B)$ . An  $Exp(B)$  is greater than 1 implies the independent variable increases the Logit and therefore increases odds (event). If  $Exp(B)$  is equal to 1, the independent variable has no effect. And if  $Exp(B)$  is less than 1.0, then the independent variable decreases the Logit and decreases odds (event). With regard to Logit model estimated coefficients; positive regression coefficient indicates that the explanatory variable increases the log-odds of the outcome, while a negative regression coefficient means that the predictor variable decreases the log-odds of that outcome. In this case, negative coefficient will produce odds ratio between the range of 0 to 1 and positive coefficient will result odds ratio to be greater than 1.

**Table 5: Logistic regression**

<i>Independent variables</i>	<i>Binary logistic</i>	
	<i>Dependent variable: OPT FOR INT CASH WAQF MODEL</i>	
	<i>B</i>	<i>Exp(B)</i>
<i>Constant</i>	1.827*** (0.458)	6.215
<i>Dummy GENDER</i>	-0.458 (0.308)	0.632
<i>Dummy AGE</i>	0.727* (0.389)	2.069

<i>Dummy TURNOVER</i>	2.058* (1.06)	7.827
<i>Dummy MARRIED</i>	-0.655* (0.345)	0.520
<i>Dummy EDUCATION</i>	-1.150*** (0.326)	0.317
<i>Dummy YEARS IN BUSINESS</i>	-0.254 (0.324)	0.776
<i>Dummy NO. OF EMPLOYEE</i>	0.077 (0.513)	1.08
<i>Dummy APPLY LOAN</i>	1.023** (0.495)	2.782
<i>Dummy DIFFICULTY_ BUSS CHARACTERISTICS</i>	-0.578 (0.584)	0.561
<i>Dummy WAQF AWARENESS</i>	1.047** (0.409)	2.850
<i>Dummy WAQF KNOWLEDGE</i>	0.435 (0.432)	1.545
<i>Dummy HIGH COST TRAINING</i>	0.014 (0.291)	1.014
<i>% correct classification</i>	83.6	
<i>Omnibus Chi-square stat.</i>	51.03 (sig = 0.000)	
<i>Hosmer &amp; Lemeshow Test stat..</i>	9.46 (sig.= 0.305)	
<i>Cox &amp; Snell R-square</i>	0.123	
<i>Negelkerke R-square</i>	0.200	

Note: Standard errors are in parentheses; \*\*\*statistically significant at the 1% level; \*\*5% level; \*10% level.

It is found that independent variables which are insignificant are ‘difficulty to raise external financing due to business characteristics’, ‘high cost or fees of training courses’, ‘knowledge on Cash Waqf’, ‘number of employee’, ‘number of years in business’ and ‘gender’. Other variables are significant between 1 to 10 percent levels. Variables age, annual turnover, awareness on cash *waqf* and applying external financing in the last 6 months or a year are positively and significantly affecting the probability to opt for the Integrated Cash *Waqf* model. Those micro enterprises managed by older persons tend to lead micro enterprises to opt for the model with the odds 2.069 times higher compared to those who are managed by young persons. Besides, MEs which have high annual turnovers have the odds of answering yes (opt for the model) 7.83 times higher than those who have low annual turnover. The odds of selecting the cash *waqf* model is 2.85 times higher for someone who have awareness on cash *waqf* than for a person who does not have the awareness about cash *waqf*, all other factors being equal. The odds of selecting the model is also 2.78 times higher for those who applying loans recently than those who are not applying the loan, other factors being constant. The coefficients of variables marital status and level of education are significant at 10% and 1% levels, respectively, with negative sign. Negative value of *B* for dummy of marital status indicates that an increase in the married respondents less likely to opt for the cash

*waqf* model as compared to the single respondents. For the married respondents, the odds of them to select the cash waqf model decreased by the factor of 0.52, all other factors being equal. As for education level, those respondents who have higher education levels (tertiary levels), the odds of them to select the cash waqf model decreased by the factor of 0.317, all other factors being equal.

As for diagnostic tests, the model as a whole explains between 1.2% (Cox & Snell  $R^2$ ) and 2.0% (Nagelkerke  $R^2$ ) of the variance in competition awareness and correctly classified 83.6% of cases. Hosmer & Lemeshow test statistic supports the model as being worthwhile. The Chi-square value for the test is 9.46 with a significance value of 0.305. Since the significance value is larger than 0.05 (5%), the model fits the data very well.

### **CONCLUSION AND POLICY RECOMMENDATIONS**

For micro entrepreneurs, raising capital is very important at both start up stage and the growing stage of businesses. However, based on empirical evidence, it shows that entrepreneurs face many difficulties in satisfying their funding needs. The objectives of the study are to analyze the main sources of financing of micro enterprises and the financial barriers they encountered, to develop new model of financing through cash waqf and analyzing the probability that MEs will adopt the proposed model. The research methodology is basically involved data collection through a structured questionnaire among MEs.

The findings of this study support that small business operators are unable to access bank finance and it is due to various factors. Among those factors are higher interest rate, strict documentation requirement, collateral requirement, insufficient amount of financing, long loan duration and characteristics of business. These findings are consistent with most previous studies of micro enterprises in Malaysia. The study also finds that high probabilities of micro enterprises to opt for the proposed Integrated Cash *Waqf* model for their business financing contributed by the high business annual turnovers, older entrepreneurs, those who have more awareness on cash *waqf* and those have experienced applying loan recently. Based on these findings, it is recommended that the government and relevant agencies would be able to improve the existing policies by using alternative fundings such as *waqf* and others. If the government would plan to use the proposed cash *waqf* model, high probability that the model will be successfully accepted are by those who

are fully aware about cash *waqf*, among those who are experiencing difficulties in applying loans recently as well as among higher income enterprises and older entrepreneurs.

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