



Microfinance in Malaysia: time to rebuild

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Introduction

This is an account of recent developments in the major microfinance institution in Malaysia, AIM, which is the oldest and one of the largest Grameen Bank replications in Asia.

Following unfavourable publicity given Grameen bank itself in late 2001 in the Wall Street Journal, AIM's current problems are not good news for the many supporters of the Grameen model. Perhaps, as David Gibbons says, the WSJ coverage will serve as 'a wakeup call' to:

...spur the industry toward ... implementing performance and reporting guidelines and standards. The need is of particular importance on loan portfolio quality, as the loans outstanding are...a microfinance organization's most important asset (Gibbons 2002).

Certainly the experience of Amanah Ikhtiar Malaysia (AIM) over recent years appears to bear out Gibbons' words.

Background to microfinance in Malaysia

Malaysia is classified as an upper middle income country by the World Bank. This is an important factor in the approach taken to poverty alleviation through microfinance in Malaysia, an approach deriving from the New Economic Policy (NEP) which operated from 1971 to 1990. The NEP was directed to reducing poverty and income disparities between ethnic groups, and particularly to improving the position of the Bumiputera. These are the indigenous peoples of Malaysia, who were seen as economically disadvantaged by comparison with other ethnic groups, particularly the Chinese.

Malaysia has a modern financial system with a diverse range of institutions, both private and public, including Islamic banks. Public institutions include development financing institutions ³/₄ a development bank and an agriculture bank (Bank Pertanian), as well as the Credit Guarantee Corporation (CGC) which provides guarantees on lending by other financial institutions to small and medium enterprises (SMEs). At the lower end CGC has a credit guarantee scheme for 'hawkers and petty traders', but loan sizes for this scheme suggest it is operating at a level somewhat above conventional microfinance. The smaller loans guaranteed by CGC would, however, qualify in terms of the definition of microfinance used in the ADB Microfinance Development Strategy for the Asia-Pacific region (ADB 2000, 1):

Microfinance is the provision of a broad range of financial services such as deposits, loans, payment services, money transfers, and insurance to poor and low-income households and their micro-enterprises.

There are also urban credit cooperatives, but these serve a salaried clientele, while rural credit cooperatives have minuscule outreach and the cooperative movement as a whole is in a weak condition with Government now attempting to revitalise it. Essentially, the only institutions engaging in microfinance are drawn from the NGO community, where there is one dominant MFI and a handful of minor operators.

Among other factors, interest rate controls may have played some part in keeping commercial banks out of microfinance. McGuire, Conroy and Thapa (1998, 185) noted that Bank Negara, the central bank, restricted the spread between base and maximum lending rates in the commercial banking system to 4 percent, less than would be required to cover the extra costs associated with microfinance lending. In the case of some loans guaranteed by CGC the permissible spread was only 2 percent, reinforcing this effect. There has been some engagement by regulated financial institutions with microfinance in other ways, however, and this is described below.

Amanah Ikhtiar Malaysia: the dominant institution

Malaysia's dominant MFI, Amanah Ikhtiar Malaysia (AIM), was established in 1987. Up to 1998 it made some 103,000 loans and disbursed a total of RM 328 million (\$86 million at the current exchange rate, considerably more if contemporary exchange rates are applied). Some 80 per cent or more of all funds loaned were for economic purposes, the remainder for 'social' purposes (Sukor Kasim 2000). AIM's activities have been directed almost entirely to the alleviation of poverty among poor Malays.¹ It was set up with a charter 'to disburse small loans on reasonable terms exclusively to the very poor households to finance additional income-generating activities' (Gibbons and Sukor Kasim 1990) but for all practical purposes has confined its attention to the Bumiputera, the indigenous (principally Malay) people. This is evident from its outreach data rather than from its charter.

Believing that while the NEP had successfully reduced the number of households in poverty, the persistence of hardcore poverty required a new approach, AIM adopted the Grameen Bank model, with some modifications to suit the Malaysian context. An official survey in 1989 indicated that some 94,600 households, or 2.2 percent of the total population, were classified as 'hard core poor', with incomes below half the level of the official poverty line. The indigenous Malay community was disproportionately represented among these poor households. AIM, intent on targeting the poorest among the poor, used the official periodic Household Income Survey as a guide and developed its own means test to identify the hardcore category.

By August 1994, AIM had some 6,100 Grameen groups in operation with a total membership approaching 30,000 borrowers. Assuming that its procedures to identify the poor were both effective and consistently applied, this is quite impressive coverage of the target population, achieved in seven years. As discussed below, outreach might have been higher, but for political interference. Total loans disbursed to that time amounted to RM37.9 million (\$14.8 million) and, reflecting the relative priorities accorded savings and credit, total savings were \$1.8 million. Some 28 per cent of lending was for agriculture, 46 per cent for trade, 15 per cent for animal husbandry and 10 per cent for other activities (Conroy, Taylor and Thapa, 1995, 20).

In Malaysia, because of the sensitivities of its Muslim clients and sponsors, AIM levied 'service charges' on loans rather than interest expressed in percentage terms. If calculated as interest on the principal involved, however, these charges were well below rates in the Malaysian commercial banking sector. For example, the average loan size for borrowers taking a third loan in 1994 was RM1,044 (\$427) for which the service charge equated to around 4.7 percent flat over the usual one year loan term. Service charges on larger loans were somewhat higher in percentage terms, but these were only a small proportion of total advances; for all classes of loans service charges covered only a portion of AIM's lending costs (Conroy, Taylor and Thapa, 1995, 21).

Some 60 per cent of AIM's operational costs between 1989 and 1995 were covered by a Malaysian Government grant, while the state governments granted additional support of up to 40 per cent annually. In consequence AIM had limited stimulus to strive for self-sufficiency in its early years (McGuire, Conroy and Thapa 1998, 178-179). Loan capital was provided by central government grants, supplemented by soft loans from CGC and some commercial banks, especially those with majority government shareholding.

However, from 1992 a constraint on expansion of outreach operated, due to a government decision to channel a grant of \$7.3 million intended for loan capital over the period 1991 to 1995 through YPEIM, an Islamic foundation. YPEIM, however, decided to program the disbursement over a much longer period, a decision which according to a recent evaluation of AIM's program caused a serious cash flow problem and undermined AIM's plans for expansion and the achievement of viability (Sukor Kasim 2000).

A loss of direction

Soft loan financing from regulated financial institutions, mentioned in the previous paragraph, tided AIM over cashflow difficulties from 1992, and indeed permitted an increase in loan ceilings from 1994, after the departure of the founding

management.² According to the recent evaluation, the average loan size jumped by 400 percent between 1994 and 1998, and this was accompanied by an increase in portfolio at risk. (Sukor Kasim 2000, 307). AIM's expansion from 1994, at which time it had reached some 50 per cent of its target group in Peninsular Malaysia (Sukor Kasim 2000, xii) appears to have been more in terms of value of loans outstanding than increased outreach to the hardcore poor. The evaluation notes that the restoration by central government of loan capital funding in 1997 sparked a further upward revision of loan ceilings, coinciding with a blowout in operational costs. An increase in numbers of 'dropouts' from the program, especially among poorer members, was noted from 1994 as loan sizes increased, a trend which accelerated from 1997.

Citing 'blatant disregard of the fundamental Grameen principles', Sukor drew attention to 'leakage [of loans] to the 'not so poor' and the 'non poor'. 'It is vital for [AIM] to relay the message that their outreach is women who are at the bottom two-third of the poverty household level as the author uncovered that due to relaxation on means testing, the less poor and the non-poor are motivated to become [AIM's] members' (Sukor Kasim 2000, 324). He is particularly critical of two loan programs introduced after 1997. The first was given the name 'SPIN'. The SPIN was directed to men in the fishing industry. The second was titled SP-IT, directed at 'Single Mothers' (female heads of households). Participants were offered an unprecedentedly high first loan of RM10,000 (\$2,650). With the diversion of AIM's attention to larger loans and better-off borrowers, the evaluator was also concerned about the implications of this development for credit discipline and portfolio quality.

Whether the inclusion of larger borrowers is a problem, per se, is largely a matter of perception. Other MFIs might do so to diversify risk and improve overall sustainability, but the evaluator takes the view that, in terms of AIM's charter, larger loans amount to 'mission drift'. And there may be particular political circumstances affecting the choices made for AIM. In the event, the admission of people to the program who are out of sympathy with its objectives has had a corrosive effect on sustainability.

By the end of 1998, portfolio at risk (PAR) had risen to 3 per cent (Sukor Kasim 2000, xviii), not too serious as an end-point but certainly a warning as a trend indicator. But by the end of 2000, the PAR of the whole AIM program with RM100 million outstanding had increased to 10 per cent, with SPIN at 60 per cent PAR and SP-IT at 36 per cent (Sukor Kasim, pers comm 10/01). These are levels which indicate grave problems for the AIM program.

In 1997 AIM decided to break with its early practice by raising the interest rate on loans to a uniform 19 per cent. Not only was this a substantial increase, it also expressed borrowing cost as a percentage of principle for the first time. The evaluation suggests this accelerated the loss of poorer clients from the program, not just because an increase in costs would depress demand but because many of the poorest are devout and would find the interest charge unacceptable.

While management's decision to increase charges is understandable, as being consistent with movement away from subsidies and progress towards financial sustainability for AIM, it does raise an important issue in the particular circumstances of Malaysia. An earlier discussion of funding policy, set in a comparative context (McGuire, Conroy and Thapa 1998, 186) made the judgment that the then official policy of subsidising microfinance was appropriate in the circumstances of Malaysia. It would still be appropriate to do so now, given the relatively small numbers of the hardcore poor and the relative prosperity of Malaysia, provided that AIM settles on an objective set of targeting principles without hint of political considerations and concentrates on running a lean and cost-effective operation. At the end of 1998 AIM had 40 branches and 6 Area offices serving some 39,000 borrowers and almost 56,000 members. The evaluation refers to the need for 'a major and expensive rehabilitation exercise'. The more recent trends in portfolio at risk appear to underline the correctness of this judgement.

Postscript³

More recent events are recounted in an article in *Credit for the Poor*, the Journal of Cashpoor, the international network of Grameen replicators (Todd 2002). In December 2001, following a Central Bank audit, senior staff of AIM were suspended and a Government line of credit for onlending was frozen. AIM's management information system is reported as having broken down, and while arrears were said to be still at 10 per cent of portfolio at end-2001, *Credit for the Poor* speculates that PAR may prove to be double this proportion. More optimistically, it is noted that:

AIM has a cadre of very experienced operations staff who have the capacity to solve problems in the field. However, this group, who are mainly women, have found themselves subordinated over the past few years to officers appointed from outside, all men.

It is reported that these staff:

...see a politically neutral and expert Board as essential to the task of solving AIM's repayment problems in the politically divided northern and eastern states where most of AIM's clients live (Todd 2002).

It remains to be seen whether the recent management shakeout will be succeeded by a period of stabilisation and recovery. AIM's Board is reported as negotiating the return of experienced senior staff and management and we must hope it can succeed in bringing its loan book under control and re-establishing its original mission of serving the poor in Malaysia.

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Endnotes

- ¹ For discussion of the emergence of AIM in the context of the New Economic Policy, see McGuire, Conroy and Thapa (1998), 175-178.
- ² David Gibbons and Sukor Kasim both left AIM in 1993 and resigned from its Board in 1994 (Todd 2002).
- ³ This material has been added since the paper 'Challenges of Microfinancing in Southeast Asia' went to press.