Malaysia

Fund for Small and Medium Scale Industries

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Field Survey: March 2006

1. Project Profile and Japan's ODA Loan

Map of project area


An example of a sub-loan borrower in the project

1.1 Background

Small and medium-sized enterprises (SMEs) are said to account for approximately 90% of the enterprises in Malaysia's manufacturing sector, and have played an important role in the country's industrialization and export promotion from the 1980s onwards. However, affected by the currency crisis of 1997, the domestic economy faced major difficulties. Although the Malaysian Government adopted measures to tighten finances such as raising interest rates, coupled with an increase in non-performing loans (NPLs) due to economic stagnation, the credit squeeze caused by these tightening measures led to a credit crunch among financial institutions, and had a serious effect on the supply of capital to SMEs. In order to address this credit crunch, in January 1998 the Malaysian Government established a "Fund for Small and Medium Scale Industries," and started an institutional finance scheme for SMEs. Responding to a request from the Malaysian Government, this project gave financial assistance to the Fund[1] through the provision of ODA loans (two-step loans).

1.2 Objective

To develop SMEs in Malaysia through the provision of long-term, low-interest loans for fixed asset investment funding etc., via financial institutions, and thereby contribute to the promotion of SMEs, the expansion of supporting industries, and

[1] Based on the New Miyazawa Initiative, devised in 1998 in an attempt to overcome the economic difficulties of Asian countries affected by the currency crisis, in addition to promoting real economic recovery, this project was implemented as part of the mid- to long-term funding assistance provided to Malaysia.

the generation of employment.

1.3 Borrower/Executing Agency

Malaysia/Malaysian Industrial Development Finance Berhand (MIDF), Bank Pembangunan & Infrastruktur Malaysia Berhad (BPIMP), Bank Industri & Teknologi Malaysia Berhand (BITMB)[2]

1.4 Outline of Loan Agreement

Loan Amount Disbursed Amount	16,296 million yen 15,646 million yen
Exchange of Notes Loan Agreement	March 1999 March 1999
Terms and Conditions - Interest Rate - Repayment Period (Grace Period) - Procurement	 0.75% p.a. (sub-loan) 0.75% p.a. (consulting services) 40 years (10-year) General untied
Final Disbursement Date	March 2004
Feasibility Study (F/S) etc.	1988: AJDF[3] Category B (BPIMB, BITMB, MIDF) loan agreement 1992: Small and Medium Scale Industry Promotion Program (BPIMB, BITMB, MIDF) loan agreement

2. Evaluation Result

2.1 Relevance

2.1.1 Relevance at the time of appraisal

The Seventh Malaysia Plan (1996-2000), in effect at the time of appraisal, identified improvements of SME productivity and competitiveness, the development of modern SMEs, and the formation of an efficient industrial structure as key objectives, to be achieved through the improvement and reinforcement of support programs for SMEs. In addition, the Second Industrial Master Plan (1996-2005) identified the development of SMEs that form linkages

2 Following the September 2005 merger of BPIMB and BITMB to form the new BPMB (Bank Pembangunan Malaysia Berhad), the SME Bank (SMEB) was set up as a subsidiary of the BPMB to handle SME loans. There has been no change to the MIDF.

3 ASEAN-JAPAN Development Fund

with large enterprises and which contribute to improvements in domestic added value as a key policy, expecting that the creation of competitive SMEs could respond to the trend towards domestic procurement of parts and equipment. In light of policies orientated towards strengthening the role and contribution of such SMEs, and within the framework of the "Fund for Small and Medium Scale Industries" established in 1998[4], this project was intended to meet demands for funding SMEs which were experiencing fund-raising difficulties as a result of the 1997 currency crisis and the financial tightening measures that followed, and as such was both relevant and highly necessary.

2.1.2 Relevance of the plan at the time of ex-post evaluation

The mid-term review of the Eighth Malaysia Plan (2001-2005) points out that SMEs are the foundation for strengthening the industrial sector, and identifies development of SMEs that have competitiveness and mobility, and are capable of contributing to the creation of industry clusters, as a key objective. The Third Industrial Master Plan (2006-2020), which is currently under development, is scheduled to commit to a variety of technical and financial assistance policies targeting improved market access for SMEs, the promotion of activities involving technical innovation and information technologies, and the promotion of linkages with key industries. In addition, the SME Development Council[5], established in 2004, has acknowledged the importance of policy-based lending support in facilitating access to capital markets. Moreover, given the fact that the framework of the "Fund for Small and Medium-Scale Industries" is still in place, this project, which aims to develop SMEs via the provision of financial assistance, continues to have relevance.

2.2 Efficiency

2.2.1 Outputs (project scope)

Three banks acted as the executing agencies (hereafter "PFIs" (participating financial institutions)) in this project: Malaysian Industrial Development Finance Berhand (MIDF), Bank Pembangunan & Infrastruktur Malaysia Berhad (BPIMP), and Bank Industri & Teknologi Malaysia Berhand (BITMB). The scope of the project relating to fixed asset investment and working capital assistance (sub-loan

[4] The Fund for Small and Medium Scale Industries was set up in January 1998, under the supervision of the Central Bank, by the Malaysian Government using its own funds. The ODA loans in this project were provided to a special account of the Fund, managed by the Malaysian Ministry of Finance. Through a subsidiary loan agreement, the Ministry of Finance sub-loaned the funds to the executing agencies (the PFIs).

[5] Established in June 2004, this is an office with the function of supervising and making decisions relating to policies promoting SMEs; it is made up of relevant ministries and agencies with the Central Bank as its head office.

component), through the provision of a two-step loan[6], is shown in Table 1 (as well as in the table in the final page, showing major comparisons of the plan with actual performance), and the project was implemented with no significant changes to project scope. The consulting services originally planned to accompany the project were cancelled as they were not requested by the PFIs, and the funds were allocated to the sub-loan component. The scope of eligible enterprises was changed in August 2001 in line with the definition of Malaysian SMEs[7], and the terms were relaxed with the aim of making it possible for even more SMEs to make use of the funding.

Table 1. Comparison of Project Scope (Sub-Loan Financing Eligibility and Lending Terms) of the Plan at the Time of Appraisal, and Actual Performance

Item	Plan	Actual performance
1) Eligible enterprises	: Private enterprises engaged in manufacturing, agro-processing, and service sectors : Locally owned enterprises (more than 51% of Malaysian equity share), with no more than 3 million Ringgit Malaysia (RM) of paid-up capital, no more than 150 full-time employees, and an annual revenue of RM25 million or less	Although all other criteria were maintained, eligible enterprises were SMEs with no more than 150 employees <u>OR</u> with an annual revenue not exceeding RM25 million.
2) Eligible projects	: Investment to improve, replace and expand production equipment, processes, and machinery : Investment in common service facilities : Technical assistance related to the above projects	No change.

6 A financing method in which loans are extended to local financial institutions, which then sub-loan those loan funds to local enterprises. Loans extended to local enterprises by local financial institutions are called “sub-loans,” whilst projects eligible for loans are called “sub-loan projects.”

7 The latest definition (December 2004) of small and medium-sized enterprises/industries, according to the Small and Medium Industries Development Corporation (SMIDEC): manufacturing sector = no more than 150 employees or annual revenue of no more than RM25 million; service sector = no more than 50 employees or annual revenue of no more than RM5 million.

Item	Plan	Actual performance
3) Type of financing and loan limit		
: Fixed asset financing	: Up to 85% of total fixed asset cost	No change.
: Working capital financing only	: Up to RM500,000	
: Working capital financing (combined with fixed-asset financing)	: Up to 20% of total loan amount * The approved amount of working capital financing lending shall not exceed 30% of the first generation fund approved amount	
4) Target region	Country-wide	No change.
5) Lending rate	Floating (with an upper limit of 7.75%)	At each bank, the interest rate was initially 7.25% in Mar. 1999, then revised to 7.00% in Aug. 1999, and again, to 6.25%, in Apr. 2001
6) Loan amount	RM50,000-RM5 million per loan	No change.
7) Repayment period		
: Fixed asset financing	: 5-15 years (with a grace period of up to 3 years)	No change.
: Working capital financing	: Up to 1 year	

With lending rates kept the same between each bank, based on a comparison with market interest rate trends (base lending rate + around 1-2%), an attempt was made to set a low rate, starting at 7.25% per annum (p.a.) at project launch, then revised to 7.00% p.a. in August 1999, being further revised down to 6.25% p.a. in April 2001 (Table 2). However, although other policy-based lending schemes with similar objectives were offering even lower rates of interest (4-5%)[8], they did not bring significant adverse effects to this project.

[8] For example, one could cite MIDF's Modernization & Automation Scheme (4.0% p.a.), BPIMB's Quality Enhancement Scheme (4.0% p.a.), or BITMB's Financial Package for SMIs (3.5-5.0% p.a) (these were re-packaged in 2002 as the Soft Loan Scheme for SMEs, managed together by MIDF).

Table 2. Trends in the Lending Interest Rates of this Project, and in Base Lending Rates

	1998	1999	2000	2001	2002	2003	2004
Lending interest rates of this project	-	7.25-7.00%		6.25%			
Base lending rate	8.04%	6.79%		6.39%		6.00%	
Market lending rate (estimated)	9.0-10.0%	7.8-8.8%		7.4-8.4%		7.0-8.0%	

Source: PFIs, Central Bank

2.2.2 Project Period

As originally envisaged, this project was completed on the date of final disbursement (the deadline for payments to sub-loan borrowers by the three PFIs was March 2004). However, during the project implementation period, disbursement of sub-loans by the BPIMB and BTIMB was stagnant, and although the Malaysian Ministry of Finance considered applying for a 1-year extension so as to ensure the take-up of all available project funds, in the end that idea was dropped.

There was a desire for prompt fund provision with this project, as a response to the economic crisis. However, in the project's first year following its launch, time was required for implementation preparation, and the PFIs, which had relatively small customer bases, were required to develop their marketing activities. In addition, there were other schemes offering lower interest rates, leading to difficulties in securing sub-loan borrowers and delaying the start of lending. In terms of the project period overall, although sub-loan approval proceeded smoothly with the exception of the first year, there were many cases in which time was required between approval and loan disbursement, and ultimately there was a failure to disburse the whole amount of funding available for loans within the implementation period (see item 2.2.3).

2.2.3 Project Cost

With project costs being financed in the local currency, set against the planned project cost (the amount eligible for lending) of 16,296 million yen, the actual disbursed amount to PFIs (the amount they received) in total was 15,646 million yen (equivalent to RM478.1 million). Regarding disbursement of loans to sub-loan borrowers by BPIMB and BITMB, although the approved amount of sub-loans well exceeded the fund received by each PFI, delays in actual sub-loan disbursement resulted in funds being left unused. Listed below are the reasons for delays in financing approval, along with reasons for loan disbursements which did not proceed as envisaged.

Reasons for Delays in Sub-Loan Approval

- Changes in business plans or their prerequisites
- Insufficient preparation of counterpart funds, which must be raised personally by the borrower
- Insufficient preparation of documents required for financing application and appraisal, such as financial statements

Reasons for Delays in Loan Disbursements to Sub-Borrowers

- Delays in complying with the following Conditions Precedents
  * Acquiring the requisite approvals for sub-loan project implementation
  * Acquiring the requisite legal documents for mortgage settings
- Requests to change the loan terms after loan agreements had been reached
- Delays in the progress of the financing-eligible projects themselves
- Hold-ups in the preparation of documents required for sub-loan disbursement (invoices, cargo documents, bills of credit, etc.)

2.2.4 Evaluation of appraisal procedures and lending terms

With loan appraisal, all PFIs, in the same way as their usual financial operations, carried out evaluations of borrowers' finances, appraisals of project plans and possibility of repayment, collateral evaluations, appraisals of enterprises' management capability, evaluations of the technological validity of purchasing machinery and equipment as well as of the feasibility of implementation, and checked the acquisition of licenses relating to land use and environmental regulations, etc. Of the loan applications which were formally received, in cases where they did not meet approval for this project, excluding those which did not satisfy the basic terms required to be worthy of approval, the possibility of applying other policy-based lending schemes was considered.

After conducting a beneficiary survey of sub-loan borrowers[9], regarding the appraisal procedures of each PFI, out of the 92 responses, 46.7% said that the appraisal takes longer than for private financial institutions and 33.7% said the documentary requirements are greater. Although 29.3% said that procedures are complex and onerous and 28.6% reported that the time to disbursement is lengthy, the majority assessed duration, documentary requirements, and procedures as being appropriate. However, with the period of time between application and approval being a long one, there were also some borrowers who claimed that the business environment had changed during that period, which affected the content of project plans.

[9] After distributing questionnaires to project sub-loan borrowers, a total of 97 responses were obtained.

Furthermore, regarding the lending terms, out of the 90 responses, 7.7% were dissatisfied with the loan ceilings, 12.4% with the repayment period (particularly that for working capital financing) and 8.9% with interest rates. Concerning working capital financing in particular, PFIs also said they would like to see an increase in the extension of the repayment period (in other policy-based lending schemes, some were set at three years), as well as the loan limit amount. Where there had been applications for working capital financing in addition to fixed asset financing, there were cases in which it was not possible to respond to the needs of the customer due to restrictions on the repayment period and limit amount, and only the working capital was allocated, under a scheme entirely separate from this project.

2.3 Effectiveness

(1) Actual performance of sub-loans

The number of sub-loans in this project was 483, with the amount (on a first generation approval basis[10]) reaching RM547.7 million. The breakdown for these is shown in Figure 2. However, while many other policy-based lending schemes go to Malay enterprises, under this project approximately 80% of the loans were extended to non-Malay enterprises, due to the fact that eligibility was not restricted.

(a) By type of business and purpose of sub-loan

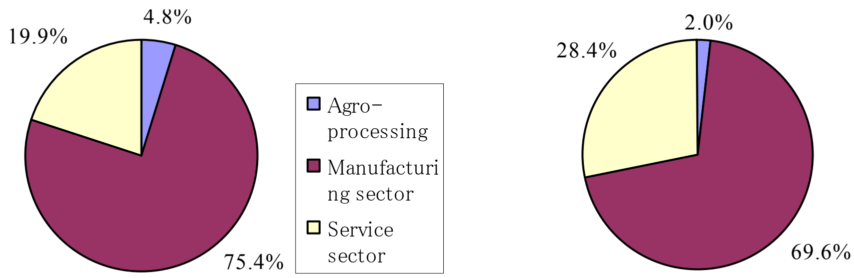
Fig. 1. A company which purchased operational machinery through the project

If one looks at the figures by type of business, manufacturing industries accounted for a large majority of loan borrowers, and within those, two types—the metal processing and plastic molding-related industries accounted for approximately a one-third share in terms of both the number and amount of first generation loans. The majority of loans to service industries were extended to transport and marine transport (ferries, etc.), operators that have limited access to the financing services of commercial banks due to the nature of their collateral.

[10] Total for the 3 PFIs. The figure is the total of the amounts submitted by each PFI as first generation funding (the amount of loans that had been approved by the sub-loan disbursement deadline of the end of March 2004). Although the cumulative total of actually approved loans exceeds the project cost on a disbursed basis (as of the end of March 2004), the undisbursed amount was replenished by repayments (in other words, revolving funds) from sub-loan borrowers to whom loans had already been disbursed in the project.

Fig. 2. Breakdown (By Type of Business) of Actual Performance of Sub-Loans

Left: number of loans/Right: loan amount basis

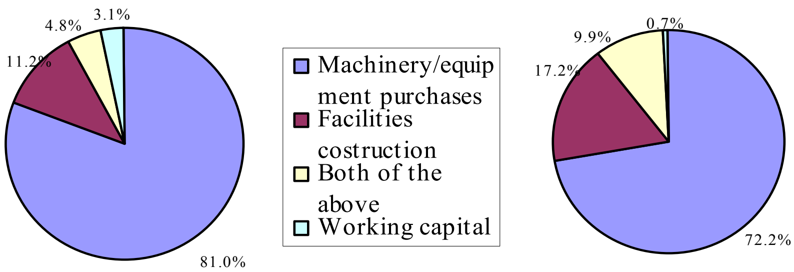


Source: PFIs

In terms of purpose, the majority of loans were used to purchase new machinery or equipment, targeting production capacity expansion, equipment improvement and/or new product manufacture (see Fig. 3). The fact that there were almost no instances of facilities being upgraded simply due to their being dilapidated was a point noted in the evaluation. Although a large majority of working capital loans were used to purchase raw materials and fuel, if one takes an overall view there were restrictions regarding the repayment period and loan limit amount, and the proportion of working capital financing was tiny.

Fig. 3 Breakdown (By Purpose) of Actual Performance of Sub-Loans

Left: number of loans/Right: loan amount basis



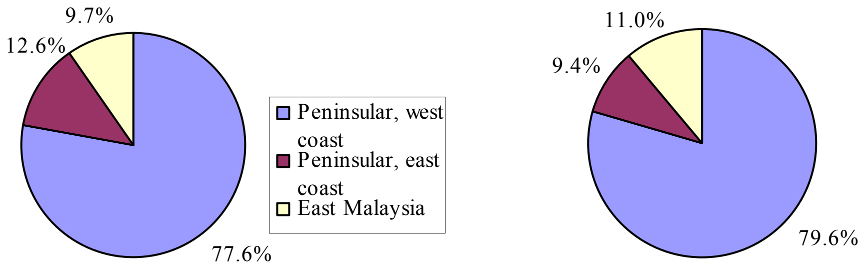
Source: PFIs

(b) By region

Although each of the PFIs has a branch in each major city in Malaysia, and sub-loan borrowers were found in almost all states, approximately 80% of the loans (in terms of both number and amount) were provided to companies located on the west coast of Peninsula Malaysia, the industrial heartland. In terms of states, the west-coastal states of Selangor, Johor and Penang accounted for more than half.

Fig. 4. Breakdown (By Region) of Actual Performance of Sub-Loans

Left: number of loans/Right: loan amount basis



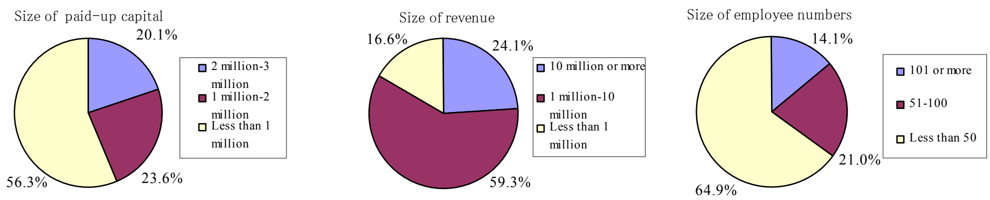
Source: PFIs

(c) By borrowers' business scale

In a breakdown based on the scale of businesses operated by borrowers, a large number of loans went to enterprises categorized as small enterprises[11] (and micro-enterprises), with revenue of no more than RM10 million, or with no more than 50 employees.

Fig. 5 Breakdown of Actual Performance of Sub-Loans

(Loan Number Basis/By Size)



Source: PFIs; data on employee numbers for two of the enterprises was not available

The table below shows the loan approval amount per loan in terms of the business scale of the borrower. In terms of overall trends, the higher the amount of paid-up capital and revenue, the larger the amount borrowed, but loan amounts were not necessarily in proportion to the number of employees.

[11] A standard within the manufacturing sector. In the service sector it is even lower, with revenue of no more than RM 1 million, or no more than 19 employees.

Table 3. Loan Approval Amount Per Loan, By Business Scale (RM1000/loan)

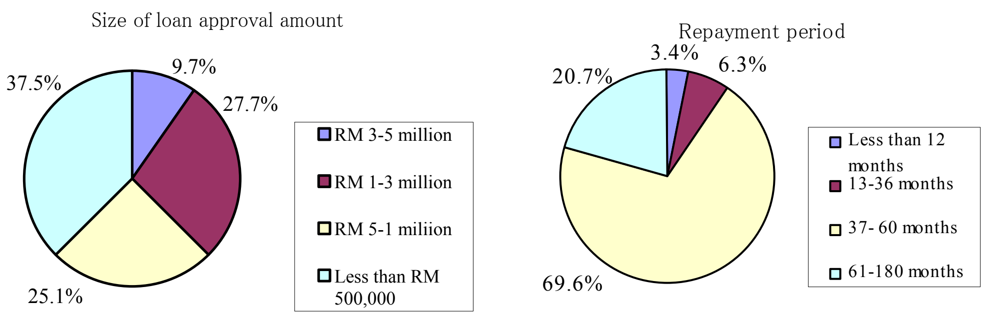
Paid-up capital (RM)		Revenue (RM)		Number of employees	
2 million - 3 million	1,686.7	10 million or more	1,648.6	101 or more	1,400.1
1 million - 2 million	1,379.9	1 million - 10 million	1,074.4	51 - 100	1,529.2
Less than 1 million	836.1	Less than 1 million	106.9	No more than 50	935.0

Source: PFIs

(d) By loan amount and repayment period

If one looks at the figures by loan approval amount, small-scale loans of under RM 500,000 were the most common, followed by loans of RM1-3 million. If one looks solely at fixed asset financing, with the sub-loan amount per loan being in the order of approximately RM1.16 million, on average a little over approximately 50% of the overall project costs of projects eligible for loans were covered by lending from the PFIs. In terms of the repayment period, with the number of loans repaid in the comparatively short period of 36 months or less remaining at a low level, it is clear that the provision of mid- to long-term loans (3-5 years) formed the bulk of loans, in line with the objectives and policy intentions of this project. The average repayment period based on the number of loans was approximately 4.9 years (59.4 months), with the weighted average based on loan amount being 5.7 years (68.3 months).

Fig. 6 Breakdown of Actual Performance of Sub-Loans
(Loan Number Basis/By Size of Approval Amount and Repayment Period)



Source: PFIs; data on the repayment periods for 39 enterprises was not available. The repayment period of 12 months or under corresponds to working capital.

(2) Non-performing loans[12] and operating status of sub-borrowers

Approximately 12% of borrowers are experiencing difficulties with loan repayments (NPL included), or are already incapable of making repayment (around 3% have been foreclosed on or written off). In contrast, more than 20% of loans have been repaid in full.

Table 4. NPL Status (as of March 2005)

PFI	NPL total	NPL rate	NPL number
MIDF	RM 21.9 million	17.8 %	25
BPIMB*	RM 20.2 million	26.6 %	24
BITMB*	RM 14.2 million	21.8 %	9

Source: PFIs; Note: At the time of evaluation, BPIMB and BITMB's special accounts were still being managed separately

Market contraction, a drop in the number of business connections (including those who transfer overseas), intensified competition, and deteriorating cash flow due to soaring raw material prices are indicated as primary reasons for the conversion to NPL status. At the macro level, the impact of market contraction due to terrorist attacks and SARS, which came in the wake of the economic crisis, is implicated. In addition, insofar as it has been possible to obtain data, there is a possibility that approximately 9% are not active.

Table 5. Operating Status of Borrowers (as of December 2005)

	No. of sub-loans	%
Active	428	90.7%
Inactive (including foreclosures)	24	9.3%

Source: PFIs; Note: no data was available for 11 of the loans

2.4 Impact

(1) Growth of SMEs in Malaysia

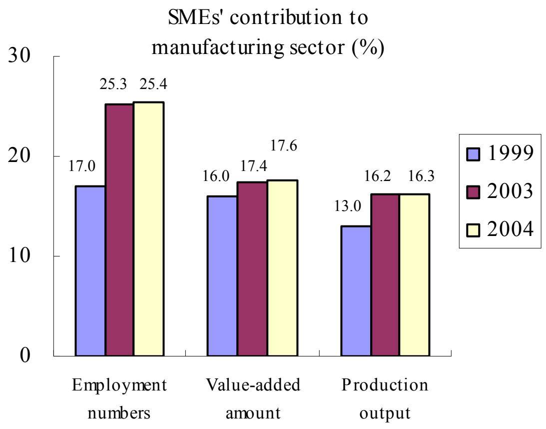
(a) Increased contribution of SMEs in the manufacturing sector

According to the National Census of 2000, manufacturing SMEs accounted for 89.3% (18,271 enterprises) of all manufacturing establishments, suggesting that approximately 2% of all manufacturing SMEs used loans from the project (first generation fund only) for fixed asset investment. Fig. 7 shows the shifts in the contribution level of manufacturing SMEs in the Malaysian manufacturing sector. Compared to the situation prior to project implementation, the contribution level

12 Definitions of non-performing loan (NPL): MIDF: overdue by 3 months or more; at the former BPIMB and former BITMB: overdue by 6 months or more (no change following the transition to SMEB).

of SMEs in the manufacturing sector as a whole is rising in terms of value-added amount and production output, and the absolute amounts of these two increased from the 2003 figures of RM12.9 billion and RM64.1 billion respectively, to RM14.2 billion and RM69.3 billion in 2004.

Fig. 7. SMEs' Contribution to the Manufacturing Sector as a Whole



Source: National Productivity Corporation (NPC)

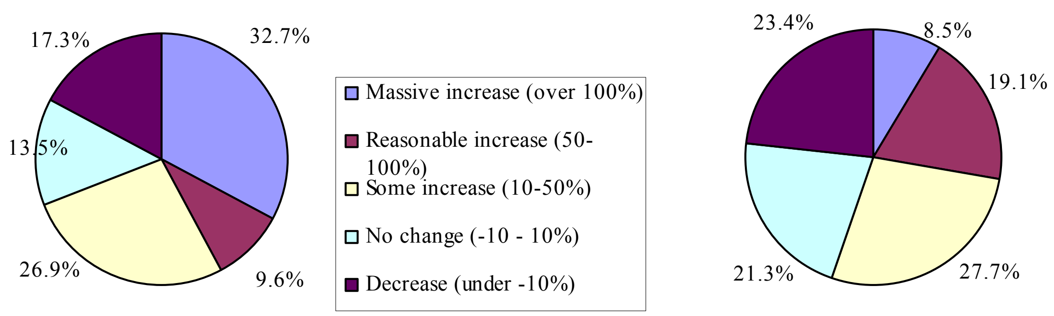
In terms of employment, although the degree of contribution has fallen compared to a few years previously (the figure was 33% in 2001), as the industry has become more capital-intensive, contribution has nevertheless risen compared to the situation prior to project implementation. The number of those employed in SMEs has also increased, albeit very slightly, from 302,000 in 2003, to 310,000 in 2004. Beginning with the Fund for Small and Medium Scale Industries, in which this project has played a part, the policy-based lending schemes for SMEs that were implemented in the wake of the economic crisis appear to have made some contribution at the macro level.

(b) Contribution to revenue/employment increases among sub-borrower enterprises

Fig. 8. Electronic circuit board manufacturing equipment purchased with a sub-loan from the project

According to a survey of sub-borrowers, more than 30% of sub-borrowers report a substantial increase (50% or more) in revenues compared to the period prior to sub-loan project implementation; this climbs to a little less than 70% if those that reported even a marginal increase (10% or more) are included. Moreover, 44% of those borrowers reporting an increase in revenue claimed a strong link with their sub-loan borrowings (50% stated that there was a link, albeit a weak one). In terms of employee numbers, although the change has not been as substantial as that experienced with revenues, a little under 30% reported large increases (50% or more), with the figure rising to over 50% if enterprises reporting even marginal increases (10% or more) in employee numbers are included. Taking the figures overall, the average number of employees at enterprises which responded to the survey increased from 65 prior to sub-loan project implementation, to a figure of 85 in 2005. From these results, one can say that the sub-loans in this project had an impact in terms of expanding the scale of SMEs.

Fig. 9 Changes in revenue (left) and Employee Numbers (right) Before and After (2004) Sub-Loan Project



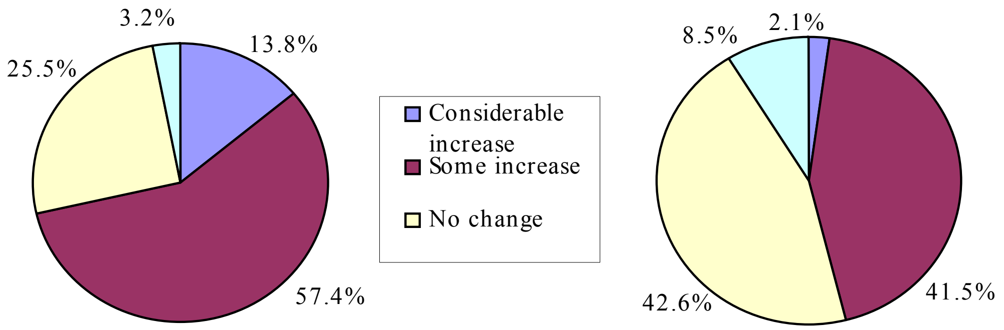
Source: Survey of sub-borrowers
Note: 52 sub-borrowers were able to provide comparative figures for sales amount, 47 for employee numbers. For the majority, pre-sub-loan borrowing equates to 2000-2001.

In addition, during 2003-04, 47% (comparative figures obtained from 85 sub-borrowers) report that revenues are still increasing, while 38% (82 sub-borrowers) report that employee numbers have continued to swell. Similarly, 48% of enterprises reporting an increase in revenues claimed a strong link with their sub-loan project.

(c) Contribution to strengthen SME linkages

Efforts to strengthen linkages by expanding their business connections, such as customers, as well as suppliers of production equipment, goods and services, are critical to many SMEs, which are vulnerable to changes in the external environment, having only limited business connections. In terms of borrower enterprises expanding their business connections, compared to the period prior to sub-loan project implementation, 71% report an expanded customer base, and 44% an increase in suppliers of production equipment and services.

Fig. 10. Changes in Expansion of the Customer Base (left) and Various Kinds of Suppliers (right) Before and After (2004) Sub-Loan Project



Source: Survey of sub-borrowers
Note: The number of responses allowing for comparison with the period prior to sub-loan project implementation was 94 for customer numbers, and 89 for supplier numbers.

(2) Easing of credit crunch problems

According to the survey of sub-borrowers, 15% of the 92 respondents stated that the decision to apply for the loan was based on difficulties in obtaining loans from PFIs. Whilst the reluctance of PFIs to lend to SMEs constitutes the macro background to the introduction of policy-based financing, the process leading up to loan application for individual enterprises was generally as follows. Many of the borrowers stated that they heard about this project and the PFIs (multiple answers possible) through routine transactions with a PFI (40%), the marketing activities of a PFI (34%) or information provision from a machinery and/or equipment supplier (22%). They responded that they had applied for the loan, having ultimately decided that interest rate and repayment period terms were favorable and that the assistance of the PFIs was appropriate.

Furthermore, from looking at country-wide changes in the amounts loaned to the manufacturing sector by commercial banks and finance companies, one can see that growth in the amounts of such loans slowed in 1999, the year this project started, as well as during 2001-2003 as the result of terrorist attacks and SARS, etc. This implies that the timing of this project was effective and that it contributed to easing the funding restrictions on SMEs.

Table 6. Changes in the Amounts Loaned to the Manufacturing Sector by Commercial Banks and Finance Companies (Millions of RM)

	1995	1997	1999	2000	2001	2002	2003	2004
Amount loaned to manufacturing sector	46,415	60,529	58,299	60,307	60,317	59,264	59,415	61,725

Source: Department of Statistics

(3) Environmental and social impacts

(a) Environmental impacts

There have been no reports of negative impacts on the environment due to implementation of sub-loan projects. Each PFI has developed guidelines and checklists for use in loan appraisal and ensured checks to determine that the relevant permits have been obtained from the regulatory authorities and that environmental impact is assessed. For sub-loan projects requiring particularly vigilant checks (food processing, chemicals, etc.), the banks' technical divisions examine project content.

(b) Promotion of female employment

According to the survey of borrowers, of the 40 enterprises able to provide comparative data, approximately half (55%) report an increase in female employment as compared to the period prior to sub-loan project implementation. Of these, 15 enterprises state that female employment has increased by more than 50%. Note that the average number of female employees among respondent enterprises increased to 27 in 2005, from 25 prior to sub-loan project implementation.

2.5 Sustainability

2.5.1 Sub-loan borrowers

(1) Loan repayment

In order to ascertain loan recovery and arrears status from the perspective of sustainability, data on basic indicators were gathered[13] from the PFIs, as shown in Table 7. From this table, one can see that whilst the cash recovery rate, which averages at more than 80%, is generally favorable, it is on a downward trajectory overall. With the exception of the BPIMB, balances as well as the number of loans in arrears at the other two banks have been on an upward trajectory for year after year, and the arrears ratio by amount for total lending, which covers NPL, is above 20% at all PFIs. However, it is commonly observed at all PFIs that it makes the arrear ratio higher as the principal repayments progress and outstanding balances decrease.

Table 7. Cash Recovery and Loan Arrears Status

PFIs	Cash recovery rate	Arrears ratio by number	Arrears ratio by amount
MIDF	87.4 %	11.0 %	22.3 %
BPIMB	85.8 %	23.8 %	26.6 %
BITMB	90.6 %	9.4 %	21.8 %

Source: PFIs
Note: The recovery rate is the average from the time of project launch, in 1999, to 2005; NPL rates are for the end of 2005 (MIDF, BPIMB) and March 2005 (BITMB). NPL are reported as sub-loan with arrears.

According to the PFIs, regarding loan arrears and the shift towards non-performing status, in addition to market factors (hold-ups in revenue recovery, declining sales, and soaring raw materials costs), some borrowers are not preparing up-to-date and adequate financial statements, making it difficult to accurately assess their operating status at loan appraisal or monitoring, which as a result leads to delinquency.

(2) Monitoring of sub-loan borrowers

Each of the PFIs monitors its sub-loan borrower enterprises regularly (depending on repayment/arrears status) checking repayment status, consistency with the lending criteria, and mortgaged properties, with the aim of resolving any problems and exploring the need for additional assistance. In cases in which it is judged that there is no prospect of loan repayment, even after adopting measures such as changing the repayment schedule etc., loans are foreclosed on and legal steps are taken. Looking at the situation regarding the use of machinery and equipment that was either purchased or upgraded with sub-loans in this project, at the time of evaluation, out of 81 responses obtained from the survey of sub-loan

[13] BPIMB and BITMB have merged, but the special accounts that have been in operation in the project thus far continue to be managed separately. Therefore, loan recovery and arrears status (including utilization of revolving funds) are reported as former BPIMB and BITMB accounts.

borrowers, 8.6% (7 borrowers) reported either breakdown or malfunction with the machinery and/or equipment they had purchased.

2.5.2 Executing Agency

This project was implemented with three banks (MIDF, BPIMB, BITMB) acting as executing agencies in addition to their participation as PFIs, under an arrangement in which project funds were sub-loaned to them by the Malaysian Ministry of Finance. Currently, two banks—MIDF, and SMEB, a newly established subsidiary of BPMB, which itself was established from the merger of BPIMB and BITMB—are acting as executing agencies[14], and are carrying out borrower monitoring and loan management in this project.

2.5.2.1 Technical Capacity

At none of the PFIs (MIDF and SMEB at time of evaluation) have there been any technical problems such as loan appraisal and loan management capability required to maintain project sustainability. They all have experience in the past of implementing two-step loan projects similar to this one under previous ODA loan funding from Japan (ADJF Category B, Fund for Small and Medium Scale Industries), and there have been no problems regarding reports of fund management and utilization of special accounts (revolving funds). In cases where applications are made for projects utilizing new manufacturing technology and machinery/equipment, both banks carry out technological appraisals of the fund project with the assistance of internal technical staff, and staffs in person at each bank explain they are able to respond to such applications.

Regarding SME loan projects, MIDF and SMEB are endeavoring to manage their operations so decisions on loan approval/refusal can be made within 45 and 60 days, respectively, from receipt of loan application. Having taken over the ISO9001:2000, certification that its parent body BPIMP acquired before SMEB was established, SMEB is attempting to standardize lending criteria and processes, as well as increase procedural efficiency. Moreover, with SMEB being covered by the "Plan to Improve the SME-targeted Advisory Service Capability of Government Financial Institutions," implemented by the Japan International Cooperation Agency in 2004, prior to the establishment of the SMEB, efforts have been made in the area of human resource development with the aim of

[14] SMEB is a government-affiliated financial institution specializing in SME finance, whilst its parent company, BMPB specializes in large accounts, infrastructure, and maritime projects.

strengthening the advisory functions of bank staff.

2.5.2.2 Operation and Maintenance system

There are no notable problems with either staff numbers or organization at any of the PFIs at the present time. All PFIs have a public relations division with sales and marketing functions, and loan disbursement to the borrower begins after this division has received the loan application and carried out a loan appraisal. Once disbursement has commenced, the loan management division takes over to perform credit management and monitoring. In 2003, MIDF executed structural reforms, bringing all operations, from sales and marketing to disbursement, into one division in pursuit of greater efficiency. The SMEB, newly formed from the merger of BITMB and BPIMB, has a considerable presence among customers, having established loan operating systems with advisory functions, based on a consolidated team of staff members with extensive experience of SME financing.

Sub-loan borrowers of the former BITMB reported some dissatisfactions stemming from the fact that applications in this project have to be filed with the Kuala Lumpur head office, stating that: i) establishing contact involves a great deal of effort and ii) there are discrepancies between the advice offered by bank branches and the head office. However, now that SMEB has taken the place of the former BITMB, attempts are being made to improve the structure, such as creating a common contact point for customers at their branches, etc.

2.5.2.3 Financial status

Table 8 shows the main financial indicators of the PFIs[15]. The earnings (interest and non-interest), profits and capital adequacy ratios of all three PFIs are stable and/or improving. Outstanding loan balances (gross) are on the increase at all the PFIs.

Table 8. Financial Status of the PFIs（Millions of RM）

		Profits	Profit after taxation	Loan balance	Capital adequacy ratio
MIDF	2002	121.8	25.5	1,113.2	64.6 %
	2003	93.6	11.7	1,133.7	52.8 %
	2004	227.8	65.8	1,147.2	50.5 %
BPIMB	2002	802.7	261.2	8,746.8	16.2 %
	2003	887.9	246.8	9,602.9	18.4 %
	2004	1,122.4	358.2	11,841.8	17.0 %

[15] SMEB was established in September 2005 upon the merger of BPIMB and BITMB. Since the SMEB has prepared no financial reports since the merger, data from the pre-merger reports of BPIMB and BITMB are reported

BITMB	2002	103.0	-529.6	n.a	4.6 %
	2003	146.5	19.1	826.1	7.7 %
	2004	174.9	45.3	928.5	10.3 %

Source: PFIs

With the exception of BPIMP, NPL rates (net) of the PFIs overall are high when compared with the overall Malaysian financial institution average of 5.8% (as of the end of 2005); 9.3% (2005 end; 21.8% of gross) at MIDF; 2.8% (7.9% of gross) at BPIMB; 8.1% (27.0% of gross) at BITMB (both figures are for 2004 end, before the merger). However, at both BITMB and MIDF this represents a decrease over the previous year (18.4% and 10.4% respectively). Moreover, loan loss reserve rates for total lending for the past three years have been fluctuating between 6.4-7.3% at BPIMB, 16.3-17.2% at BITMB and 16.7-19.6% at MIDF.

2.5.3 Utilization of the Revolving Funds[16]

At the time of evaluation, all PFIs have already started to utilize their revolving funds, created from repayments from first generation loan borrowers. However, the BPIMB and BITMB accounts are in fact first generation funds for which amounts have been approved, and the banks are only utilizing these funds for the purpose of extending loans to those borrowers (undisbursed amount) to whom loans had not been disbursed by the closing date of loan disbursement. This means that loan approval of these funds as so-called new loans has not yet begun. SMEB, which manages both these accounts, has now commenced marketing activities aimed at finding new borrowers for the second generation fund, evolving from the revolving fund. The MIDF revolving fund is being used for lending to borrowers whose first generation fund loans were approved but not disbursed, and new, second generation fund borrowers (49 loans).

3. Feedback

3.1 Lessons Learned

Due to requiring time to start disbursement after sub-loan approval, utilization of the project fund did not progress as planned. In many instances, this was the result of problems on the borrower side and, while these may prove difficult to resolve, it is hoped that efforts will be made to ascertain the status of participating financial institutions during discussions on similar projects, and that these will be reflected when the time comes to consider project periods.

[16] Surplus funds arising from the gap between the sub-loan repayment period and the ODA loan period. These funds are used for new loans.

3.2 Recommendations

Utilization of revolving funds: Considering the upward trend of base lending rates at commercial banks each PFI is expected to use its funds effectively by flexibly reviewing the terms and conditions of the second generation fund (the revolving fund) including interest rate, also considering to apply it to the working capital loans.

Strengthening of credit management: Given the tendency of the arrears ratio of this project to increase, each PFI is expected to strengthen the monitoring of loans in arrears and develop a structure in which appropriate measures against borrowers with such loans are taken.

Consideration of the significance of policy-based lending: The Malaysian Government is expected to conduct a study on the necessity and importance of policy-based lending to SME promotion (such as macro-economic impact analysis) in order to design and prepare for further effective policy-based lending schemes in consideration of the development of the commercial banking sector. JBIC is also expected to review the approach and methodology (such as outcome and impact indicators) of evaluation on two-step-loan projects and feedback into the performance management and the project formulation of the policy-based lending project.

Comparison of Original and Actual Scope

Item	Plan	Actual
①Outputs		
1. Funding assistance for fixed asset investment and working capital (sub-loan component) 1) Eligible enterprises	: Private enterprises engaged in manufacturing, agro-processing, and service sectors : Locally owned enterprises (more than 51% of Malaysian equity share), with no more than 3 million Ringgit Malaysia (RM) of paid-up capital, no more than 150 full-time employees, and an annual turnover of RM25 million or less	Although all other criteria were maintained, eligible enterprises were SMEs with no more than 150 employees OR with an annual revenue not exceeding RM25 million.
2) Eligible projects	: Investment to improve, replace and expand production equipment, processes, and machinery : Investment in common service facilities : Technical assistance related to the above projects	As planned
3) Type of financing and loan limit		As planned
: Fixed asset financing	: Up to 85% of total fixed asset cost	
: Working capital financing only	: Up to RM500,000	
: Working capital financing (combined with fixed-asset financing)	: Up to 20% of total loan amount * The approved amount of working capital financing lending shall not exceed 30% of the first generation fund approved amount	
4) Target area	Country-wide	As planned

Item	Plan	Actual
5) Lending rate	Floating (with an upper limit of 7.75%, however)	At each bank, the interest rate was initially 7.25% in Mar. 1999, → 7.00% in Aug. 1999, → 6.25%, in Apr. 2001
6) Loan amount	RM 50,000-5 million per loan	As planned
7) Repayment period : Fixed asset financing : Working capital financing	 : 5-15 years (with a grace period of up to 3 years) : Up to 1 year	 As planned
2. Consulting services	- Assistance relating to reports on sub-loan repayment status, impacts studies etc. - Appraisals, monitoring, education training, technical and management advice for customers, capacity building	Cancelled. The funds were allocated to the sub-loan component.
②Period		
L/A signing	February 1999	March 1999
Start of disbursement to PFIs	March 1999	April 1999
Lending of sub-loans	March 1999 - March 2004	April 1999 - March 2004
Project completion	March 2004	March 2004
③Project Cost		
Foreign currency	16,296 million yen	15,646 million yen
Local currency	0 million yen (0million yen)	0 million yen (0million yen)
Total	16,296 million yen	15,646 million yen
ODA Loan Portion	16,296 million yen	15,646 million yen