BUMIPUTERA'S NON-PERFORMING LOANS (NPLs):
A CASE STUDY OF SARAWAK ECONOMIC DEVELOPMENT CORPORATION
(SEDC SARAWAK).

By

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ABSTRACT

Bumiputera's Non-Performing Loans (NPLs):
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(SEDC Sarawak)

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This study is aimed to determine the root causes that contribute to the financial stress and consequent business failure of the Bumiputera participants in SEDC Sarawak financial aids schemes. To achieve this prime objective, both primary and secondary data are used, and analyzed using the Factor Analysis of the Statistical Package for Social Science (SPSS) for Windows version 11.5. The study focuses on the managerial deficiencies, financial factors, and the personal attributes and the degree of each of these factors in contributing to the financial stress that led to the financial failures of the Bumiputera participants in the two selected schemes, namely the Small Scale Enterprises (SSEs) and the Small and Medium Scale Industry Loan Scheme (SPIKS). The result of the study indicates that financial factors contributed 85.6 percents, personal attributes contributed 80.6 percents, and managerial deficiencies contributed 56.6 percents to the NPLs of the failed participants.
ABSTRAK

Pinjaman Bumiputera Yang Tidak Berbayar:
Kajian Kes Di Perbadanan Pembangunan Ekonomi Sarawak
(SEDC Sarawak)

Oleh
Insor Anak Lingan

Kajian ini bertujuan untuk mengenalpasti punca utama yang menyebabkan para Usahawan Bumiputera yang menerima bantuan kewangan daripada SEDC Sarawak gagal membayar balik pinjaman mereka mengikut jadual yang telah ditetapkan. Untuk mencapai objektif ini, pendekatan secara statistik menggunakan Analysis Faktor dalam Statistical Package for Social Science (SPSS) untuk Windows versi 11.5. Fokus kajian adalah menjurus kepada kelemahan-kelemahan pengurusan, faktor-faktor kewangan dan juga tingkah-laku peminjam itu sendiri. Kajian juga mengkaji sejauh mana faktor-faktor tersebut telah menyumbang kepada permasalahan pinjaman Bumiputera yang tidak berbayar di dua buah skim bantuan kewangan SEDC Sarawak, iaitu skim Syarikat Bersekala Kecil (SSEs) dan Skim Pinjaman Industri Kecil dan Sederhana (SPIKS).

Hasil kajian telah mendapati bahawa faktor-faktor kewangan mendahalui faktor-faktor lain dengan menyumbang sebanyak 85.6 peratus, diikuti dengan faktor tingkah-laku peminjam yang telah menyumbang sebanyak 80.6 peratus dan akhir sekali faktor permasalahan pengurusan telah menyumbang sebanyak 56.6 peratus kepada pinjaman Bumiputera yang tidak berbayar.
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May God bless all of you.
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CHAPTER 1
INTRODUCTION

1.0 Introduction.

This chapter provides an overview of the formation of SEDC Sarawak, its roles and functions, types of assistance extended to the Bumiputera as an individual and also as an enterprise, the NPLs, and its definition, the problem statements, research questions, research objectives, and also the significant of the study.

1.1 Brief Background - The Formation Of SEDC Sarawak.

SEDC Sarawak was established in Mac 1, 1972 in accordance with the Sarawak Economic Development Corporation’s Ordinance (Sarawak Cap. 35). The establishment of SEDC Sarawak was aimed to promote commerce and industry amongst the Bumiputeras in the State in achieving the objectives of the New Economic Policy (NEP) in minimizing the economic gap between Bumiputeras and the Non-Bumiputeras.
1.2 General Functions And Duties Of The Corporation.

As stipulated in Part II of section 14 (1) of the Ordinance, the Corporation is to promote the economic development of Sarawak and with the objective to carry out economic activities, and to stimulate and facilitate private investment in Sarawak by local and external capital. As stipulated in section 14 (1) (b), one of the core functions of the Corporation is to provide loans for agriculture, industry, commerce, housing, transport, and any other economic undertaking.

With regards to the Bumiputeras development in commerce the Corporation has clearly defined its objectives as follows: -

1.2.1 To stimulate commercial and industrial growth in the State.

1.2.2 To promote Bumiputera participation in commerce and industry.

1.2.3 To carry out special projects for the government to improve the general economic well being of the State and its people.
1.3 Assistance Extended To Bumiputera.

This research is focused on the non-performing loans of two main financial aid schemes that are currently managed by SEDC Sarawak. The two said schemes are as follows:

1.3.1 Small Scale Enterprises (SSEs).

This scheme was established in 1988 to facilitate and enhance the development small-scale Bumiputera entrepreneurs. The successful applicants would be awarded a soft loan of a maximum amount up to RM50,000.00 with the administrative charges of 4 percent per annum to facilitate their quest to venture into economic activities. Administrative charges are the charged enforced by the loaner to the successful loanees of the scheme as token fees for the services render by the loaner. The total amount of loan had been disbursed were RM1,818,200.

1.3.2 Small and Medium Scale Industry Loan Scheme (SPIKS).

This scheme was established in 1999. The prime objective of this scheme is to enhance the participation of Bumiputera entrepreneurs to venture in manufacturing sector, construction sector, service sector, and information technology sector. The successful participants would be given a soft loan in the range of RM5,000.00 to RM100,000.00 with administrative charges of 4 percent per annum. As at the end of October 2002, RM1,719,940 amount of loan had been disbursed.
The total amount of the financial assistance disbursed from 1989 to the end of October 2002 was RM3,538,140.00 via these two schemes to meet the objectives of SEDC Sarawak.

Other forms of financial aids schemes have also been developed to provide assistance to Bumiputeras in the State to start their business venture. In addition to these, various other forms of non-financial assistance also provided with the objectives to further enhance the Bumiputera entrepreneurs’ competitiveness in their business venture as listed below to name a few:

- Entrepreneur Training Programme.
- Young Entrepreneur Programme.
- Tourism Internship Programme.
- Entrepreneur Incubator Center.
- Business Premises.
- Terrace Factory - Manufacturing Space For Rent.
- Shop Houses and Shop Lots For Rent.

However for the purpose of this study only two mentioned schemes – SSEs and SPIKS are chosen, as these schemes are similar in nature that is to provide financial assistance to enable the Bumiputera entrepreneurs to start a small business ventures.
1.4 Performance of the Schemes As At October 2002.

The understanding pertaining to the classification of NPLs in the context of this study is pivotal. The net NPLs as defined by the Central Bank Of Malaysia are the loans without any payment made for the last six previous months\(^1\).

With regards to SEDC Sarawak owns classification - written document is not available at the time of this study being conducted, but as a normal practice, the loans are regarded as non-performing if no payment is received for three successive months after the due date of the payment\(^2\).

Table 1: Schemes’ Performance

<table>
<thead>
<tr>
<th>Schemes</th>
<th>Total Participants</th>
<th>Total Loan Disbursed</th>
<th>% NPLs</th>
<th>No. Of Failed Participants</th>
</tr>
</thead>
<tbody>
<tr>
<td>SSEs</td>
<td>72</td>
<td>RM1,818,200</td>
<td>26.85</td>
<td>22</td>
</tr>
<tr>
<td>SPIKS</td>
<td>36</td>
<td>RM1,719,940</td>
<td>45.96</td>
<td>12</td>
</tr>
</tbody>
</table>

Source: Entrepreneur Development Division: *Summary Loan Collection Status For The Month Of October 2002*. Finance Unit.

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\(^2\) Finance Manager, Entrepreneur Development Division, SEDC Sarawak. Confirmed, based on the discussion held on Sept. 4, 2003.
1.5 Problem Statement.

At national level, the Bumiputra ownership of share capital in the corporate sector decreased from 19.3 percent in 1990 to 19.1 percent in 1999 (OPP3)\(^3\). Thus, this is still far below the NEP's total target of 30 percent Bumiputera's equity in various economic sectors is still far of reach. This trend could not have been more worrying for SEDC Sarawak in its efforts to uplift the economic stature of the Bumiputras in Sarawak. Entrepreneurship development of the Bumiputra business community is crucial to the success of SEDC Sarawak's objectives. The success of the schemes would point directly to the successful development of Bumiputra entrepreneurs in the State. This would provide the impetus necessary to close the economic gap between Bumiputras and non-Bumiputras. The data as presented in Table 1 of page 5 shows that the percentage of NPLs is significant and indicates the extent of failures that need to be addressed with urgency. The acceleration of this negative trend could potentially derail and jeopardize SEDC Sarawak's noble efforts as explained earlier.

1.6 Research Questions.

What is the root causes contributing to the existence of non-performing loans by the Bumiputera participants? Could the indicators of financial distress be detected before the loans become non-performing?

\(^3\) The Third Outline Perspective Plan (OPP3) 2001-2010, [2001], PNMB, p.91
1.7 Objective.

1.7.1 General Objective.

To determine the root causes and the degree of its impact in contributing to the financial stress and consequent business failures of Bumiputra participants in SEDC Sarawak, and also to provide lessons learned and specific recommendations from the study to both SEDC Sarawak and existing participants so that the potential factors, which could lead to the failure of the business ventures, could be minimized.

1.7.2 Specific Objectives.

1.7.2.1 To determine the root causes and the degree of its impact in term of its percentage to the non-performing loans of the failed participants based on the three factors – managerial deficiencies, financial factors and personal attributes.

1.7.2.2 To determine the percentage of the sub-variables in the managerial deficiencies, financial factors, and personal attributes and their influence to the NPLs of the failed Bumiputera participants.
1.8 **Significance of the Study.**

It is crucial that the root causes that contribute to the failure of these participants be known definitively. Knowledge of these root causes would enable SEDC Sarawak to do the following:

1.8.1 Create the ideal infrastructure such as the clear credit policies and procedures for managing participants.

1.8.2 Provide relevant and tailored training – both for participants and SEDC Sarawak’s managers who are responsible for managing these participants.

1.8.3 Provide specific recommendations based on the results of the study so that the rates of the NPLs of the existing and the potential participants of the financial aids schemes could be reduced and minimized.

1.8.4 To enhance tighter control and monitor performance, providing timely feedback, thereby giving proven early indicators of financial stress by the existing and the potential participants.
1.9 Conclusion.

Since this study is the first of its kind that tries to explore the root causes of the NPLs of the Bumiputera participants of the financial aid scheme qualitatively and quantitatively in SEDC Sarawak, thus it is expected to face some drawbacks and limitations. Nevertheless, this study is so significant to SEDC Sarawak as it can assist the Corporation in achieving its objectives to further enhance the participation of the Bumiputera entrepreneurs in commerce and industry in the State. It is hoped that, many more comprehensive studies could be conducted in the future to find out more specific and definite causes of the NPLs of the failed participants.
CHAPTER 2
LITERATURE REVIEW

2.0 Introduction.

This chapter would review the pertinent factors or the predictor variables that contribute to the non-performing loans based on the previous related studied or researched, articles and other relevant materials from journals, books, magazines, web sites, government documents and others related and reliable sources. The findings in this literature review would be used to compare the findings of this research, and provide further basis for discussions.

The second step is to understand the meaning of failure in/within the context of small businesses. Small business as defined by Professor Scott Holmes and Brian Gibson (2001) of the University of Newcastle and accepted by the Small Business Coalition (SBC) is a business, which independently owned and operated, with close control over operations and decision held by the owners. Business equity is not publicly traded and the owners personally guarantee business financing. The business will have less than twenty employees.⁴

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While in Malaysia, Small & Medium Scale Industry (SMI) is classified as enterprises with annual sales turnover of less than RM25 million and with employees of 150 and below.\(^5\)

Since the actual definition for small business in Malaysia is hardly available at the time of this study is conducted, it is therefore the definition of small business as defined by Professor Scott Holmes and Brian Gibson (2001) of the University of Newcastle as accepted by the Small Business Coalition would be used to define the meaning of small businesses in the context of this study. This is because the criteria used in the definition by Professor Scott Holmes and Brian Gibson (2001) is similar in nature to the small businesses that are currently being studied in this case.

To the economists, business failure is where a rate of return on investment is less than its opportunity cost. While legal failure is where a small business is formally liquidated or in the case of a proprietorship, the owner becomes bankrupt and the business ceased its operation (Peacock R, 2000).

In general terms, failure is defined as the inability of the owner manager to continue his or her business because of financial difficulties. A termination of business is deemed to be a failure if the firm ceases operating under its existing owners and structure because it is unable to function profitably, or does so because of existing or impending failure, financial difficulty or insolvency (William, 1987).

2.1 Small Business Failure Rate.

According to the studies that had been carried out by Rolffe Peacock (2000) between the period of 1974 – 1985 entitled *Failure And Assistance Of Small Business in South Australia* the bankruptcy and liquidation of small business out of 418 businesses studied, 50 percent failed within the first two years, and 86 percent failed within five years; only 4 percent survived after ten (10) years (Peacock et. al 1986, 1988). Of 799 proprietary companies liquidated from 1974 – 1984, 33 percent failed within two years, 54 percent failed within five years and 21 percent after ten years (Peacock 1984b, 1985a, b). Similar results were established when 432 proprietary companies in Queenslands were surveyed for the period of 1970 – 1976 (Sorby-Adam, 1981), and for 863 proprietary companies unincorporated business in Western Australia and Victoria where 41 percent failed within two years and 69 percent failed within five years after the set-up (Williams, 1975).

Lowe et. al (1990) found that for the period of 1987 – 1988 and 1988 – 1989 approximately 34 percent small companies failure in New South Wales were within the first three years of their set up, and only 12 percent survived more than ten years.
Table 2: Small Business Failure Rate (1973 – 1990)

<table>
<thead>
<tr>
<th>No. Of Year After Start</th>
<th>% Of Failed Firms</th>
<th>Cum. Of Failed Firms</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>32</td>
<td>32</td>
</tr>
<tr>
<td>2</td>
<td>17</td>
<td>49</td>
</tr>
<tr>
<td>3</td>
<td>13</td>
<td>62</td>
</tr>
<tr>
<td>4</td>
<td>7</td>
<td>69</td>
</tr>
<tr>
<td>5</td>
<td>5</td>
<td>74</td>
</tr>
</tbody>
</table>


In the first year of its formation, an average of one third (1/3) of the firms failed. However, the proportion of the failures declined for each subsequent year, but the cumulative failure rates are high—69 percent after three (3) years and 74 percent after five years. The conclusion is approximately only one quarter (1/4) of the enterprises survived the five years period.

The same research had been conducted in the United States that reported similar results (Churchill, 1952; Star and Massel, 1981) and high rates had been reported in the United Kingdom (Hill, 1987; Storey et. al, 1987; Keeble, 1990).

From these studies, it could be concluded that the crucial period of a small firm’s life circle is its first year after the formation.
2.2 The Root Causes Of The Business Failure.

Thus, in this study the pertinent factors that cause the business failure such as the managerial deficiencies, financial factors, and the personal attributes are analyzed to determine how significance its contribution to the non-performing loans of Bumiputera entrepreneurs in SEDC Sarawak’s financial aid schemes.

2.2.1 Managerial Deficiencies.

Previous studied shows that discernible management errors were a major cause of retail bankruptcies (Cover, 1933). According to the study carried out by Rolffe Peacock the causes of business failure was due to poor management (Peacock, 1985c). In the United States and Canada for example, 92 percent and 96 percent respectively of the business failure were due to the related management’s problems.

In South Australia, legal failures in 1974 – 1985 found that the predominant cause of business failure was due to management inefficiency (incompetence and inexperience). The rate was between 81 percent to 91 percent for companies and unincorporated firms respectively (Peacock, 2000).

Internal factors related to management quality were twice as likely to be the major causes contributing to the failure as external factors (Williams, 1986; McMahon et. al, 1993).