

# MSMEs dwarfed by funding challenges

SME access to finance is a topic of interest for policymakers in both developed and developing countries, including Malaysia. Financial services remain severely restricted for SMEs, which means that they can't expand, innovate, or take risks.

The Securities Commission's (SC) launch of the five-year roadmap is timely, supporting micro, small and medium-sized enterprises (MSMEs) and mid-tier companies (MTCs). In today's economy, MSMEs are recognised as a vital asset. In 2022, they contributed 74% of Malaysia's GDP and employed 64% of the workforce.

The government has made significant inroads in developing a comprehensive financing ecosystem to support SMEs. SMEs financing is also complemented by financial institutions, Bank Negara Malaysia (BNM) and government funds. Under Budget 2024, RM44bil will be allocated to support domestic SMEs through grants, guarantee schemes, capacity building programmes and other financing facilities.

The numbers speak for themselves although SMEs still face financing constraints. In 2023, financing to SMEs comprised almost half of the total outstanding business financing (49.6%), with RM528bil in total financing disbursed by banks into 2.28 million SME accounts. BNM has allocated a further RM32.4bil to further enhance access to financing for SMEs.

Through 2017-2023, the capital market provided MSMEs and MTCs with a variety of fundraising options. These were LEAP and ACE Markets (RM12.8bil), venture capital and private equity (RM5.9bil) and RM6.6bil through equity crowdfunding and peer-to-peer financing.

Even though there has been a significant increase in financing for SMEs, there remains a large financing gap, including greater access to bank financing and other funding options, such as capital markets. By 2022, MSMEs are estimated to face a financing gap of RM290bil.

The characteristics embedded in MSMEs, asymmetric information flows and market infrastructure, and the banks' lending behaviour, as well as their stringent loan valuation and criteria, contribute to the intertwined impact on the MSMEs finance gap.

The inherent characteristics of MSMEs and the risk of market failure make banks wary of lending to them. SMEs' nature and business operation characteristics make loans risky. As a result, they are subject to higher credit constraints because banks have to pay high transaction and monitoring costs.



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MSMEs are perceived as risky due to a limited track record of delivering decent returns to investors, lack of better internal and external controls, lack of financial expertise, and few tangible assets as security.

Despite the availability of fundraising platforms, MSMEs and MTCs face challenges such as high costs of professional fees and compliance expenses, low awareness and lack of readiness to utilise these financing options.

There are also liquidity and exit concerns. The lack of credible and transparent information was among the issues cited by investors. MSMEs and

■ **SMEs face financing constraints despite significant efforts by the government**

■ **A large gap remains, including greater access to bank financing and other funding options**

■ **Risk of market failure make banks wary of lending to MSMEs**

MTCs cannot facilitate or promote private market deals and trade sales due to the lack of supporting infrastructure.

There is a worldwide concern about these issues, not just in Malaysia. The World Bank Group says 65 million enterprises, or 40% of formal MSMEs in developing countries, have an unmet financing need of US\$5.2 trillion (RM24.48 trillion) every year.

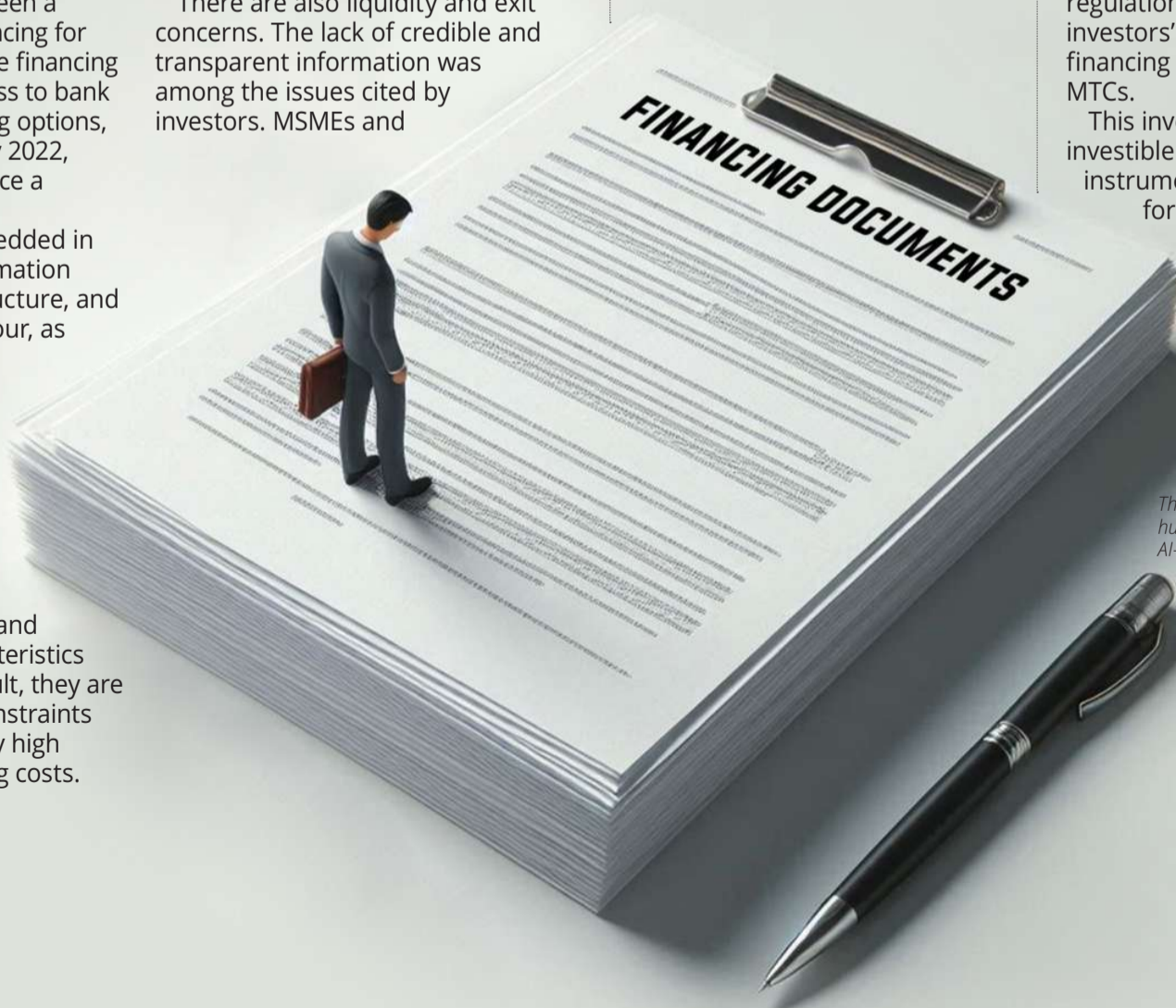
The SC roadmap aims to grow the MSMEs and MTCs' capital market fundraising from RM6.3bil in 2023 to RM40bil in 2028, an increase of 46% CAGR over the next five years. This represents up to 20% financing to be sourced from the capital market.

Addressing the issues and challenges faced by MSMEs and MTCs as well as investors is crucial to serve the financing needs of these set-ups sourced from the capital market.

To achieve the desired outcome, the SC needs to be the custodian of the roadmap, in coordination and collaboration with the key partners from ministries, agencies, stakeholders and capital market intermediaries.

The regulatory framework is a key enabler for the supply of financing instruments. The challenge for the policymakers and regulators is to design and implement effective regulation, which balances between investors' protection and support of financing channels for MSMEs and MTCs.

This involves the engineering of investible products and financing instruments to meet the appetite for high returns by financiers and investors, while MSMEs and MTCs have access to capital market financing.



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