

# An Estimation of Market Size for Microfinance: Study on the Urban Microentrepreneurs in Selangor, Malaysia

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## Abstract

Malaysia is a fast growing developing country where majority of the people are Muslim. Due to the religious bindings, Muslim prefers *Shariah* compliant Islamic credits instead of conventional interest based credits. At the same time, non-Muslims can also consider *Shariah* compliant Islamic credit because it is considered as the ethical credit. However, still many microentrepreneurs are not receiving the *Shariah* compliant Islamic microfinance products because they have negative perceptions about the credit and interest (*riba*). Therefore, this study aims to assess the demand for microfinance among the microentrepreneurs in the State of Selangor, Malaysia and thus, determine the potential market size. Data of the study were collected based on a questionnaire survey from 550 microentrepreneurs from the urban areas of Selangor. It was found that only 12.2 per cent of them received microfinance from various microfinance institutions and banks. However, the study found that still there is potential for microfinance borrowing with around 55,000-128,000 microenterprises in Selangor, Malaysia. Therefore, Islamic microfinance institutions should try to expand their market size by promoting these potential microfinance borrowers among the existing microentrepreneurs.

**Keywords:** microfinance, Islamic microfinance, microentrepreneur, microenterprise, SME, Malaysia, Shariah

JEL Classification: G21, N85, O10

## 1. Introduction

Microfinance promotes economic and social empowerment of the poor and low income people. Business capital is the most difficult to obtain for the working poor, the poor, and the unemployed, thus if they lack savings or other forms of collateral, they will find that business loans are inaccessible. In the absence of financial services, poor people often have to rely on informal financial sources such as friends and family as well as moneylenders. Microfinance institutions (MFIs) also provide financial services such as loans and insurance targeted at low-income clients or those who are not bankable.

With a population of more than 28 million of which 60 per cent are Muslims, Malaysia is a large consumer market for micro-entrepreneurial development. Here, MFIs can either be in the form of non-governmental organisations (NGO), government agencies, charitable organisations, banking institutions, non-banking organisations or a combination of these. Microfinance services that are being offered are mostly *Shariah* compliant products based on *Qard Hassan* (benevolent loan), *Ijarah*, and *Bai Al-Inah* (sale and buy-back agreement) contracts. The two largest Islamic microfinance institutions in Malaysia, Amanah Ikhtiar Malaysia and Bank Rakyat, have shown good progress over the years by availing financial access to the Muslim poor that would not jeopardize their religious beliefs towards the prohibition of interest (Dar et al., 2012; Kamaluddin et al., 2015; Said, Alam, & Hassan, 2015).

The funding of some of the MFIs depends a lot on donations and subsidies from other parties; therefore, their existence and sustainability really depends on the outreach. The more they can reach their clients, the more impressive their performances will be (Osotimehin & Akinlabi, 2011). Previous studies have indicated that demand for microfinance is based on outreach that is the ability of MFIs to reach out to the clients (Cheng, 2007;

Molla et al., 2008; Molla & Alam, 2008, 2011; Alam & Molla, 2012a, b).

Ayayi & Yusupov (2012) claimed that it is an overly simplistic projection to assume that every poor individual needs a loan. Some poor people choose not to borrow to start a business as they do not want to be in debt (Reinke, 2004). Standard and Poor's Microfinance Rating Methodology Working Group estimated that about 50 per cent of the poor worldwide are potentially eligible for microcredit/ microfinance to initiate microbusinesses which was also supported by a study done by the CGAP on microentrepreneurs in Latin America (Ayayi & Yusupov, 2012; Anand & Rosenberg, 2008; Gazy, 2005).

Given this information, there is a need to estimate the potential market size for microfinance. Therefore, the objective of this study is to assess the demand and the potential market size for microfinance among the microentrepreneurs in Malaysia.

## 2. Methodology

The study collected questionnaire survey data from 550 microentrepreneurs in several selected towns or urban areas in Selangor, Malaysia. Data were projected through the use of the 1-5 point Likert-scale, denoted by strongly disagree (1) to strongly agree (5). The sample included both recipients and non-recipients of any form of microfinance from four selected areas, they are Shah Alam / Kelang (32 per cent), Subang Jaya / Petaling Jaya (23 per cent), Selayang / Ampang Jaya (14 per cent), and Sepang / Kajang (31 per cent). Data were collected in September, 2013.

## 3. Findings and Discussions

### 3.1 Demographic Characteristics of Microentrepreneurs

In general, the respondents are almost equally distributed between both genders (Table 1). About 40.9 per cent of the respondents are in the 31-45 age groups. The majority (83.2 per cent) of the respondents are Malays, followed by 8.0 per cent Chinese, 7.1 per cent Indians, and 1.8 per cent from other ethnicities. More than 46 per cent of the respondents are running their businesses in shops, followed by the mobile night or day market; about 11 per cent of them are running home-based businesses, and another 6 per cent do not have a specific business location; they could be running an online business. More than 70 per cent of the respondents run their small scaled businesses on a full-time basis and 22 per cent of them on a part-time basis.

Table 1. Demographic characteristics of the sample microentrepreneurs

Demographic Variables		No of Respondents	(%)
Gender	Male	262	47.9
	Female	285	52.1
Race	Malay	455	83.2
	Chinese	44	8
	Indian	38	6.9
	Others	10	1.8
Age	Below 18	4	0.7
	18-30	146	26.7
	31-45	224	41
	46-60	165	30.2
	Over 60	8	1.5
Location of business	Market (permanent)	89	16.3
	Shop	255	46.6
	Night / Day market (mobile)	111	20.3
	Home	59	10.8
	Not applicable	33	6
Type of business	Full-time	424	77.5
	Part-time	123	22.5

### 3.2 Characteristics of Microenterprises

The size of the microenterprises is very small as reflected from the size of their current business capital (Table 2). Around 31 per cent of them are operating with a current capital of below RM1,000. A very small group (8 per

cent) has a capital of above RM15,000. The size of capital is also related to their ability to obtain finance. Based on the survey, all of them mentioned that they are the owners who operate and manage the business. Moreover, on average, the microentrepreneurs have only 2 full-time employees.

Table 2. Business characteristics of the sample microenterprises

Business Status		No of Respondents	(%)
Size of Business Capital	Below RM1000	168	31
	RM1000-5000	209	38
	RM5001-15000	128	23
	More than RM15000	42	8
Monthly Income	Less than RM1500	72	13.2
	RM1501-2500	149	27.2
	RM2501-3500	154	28.2
	RM3501-5000	104	19
Nature of Business	More than RM5000	68	12.4
	Trading	291	53.2
	Manufacturing	95	17.4
	Services	134	24.5
	agriculture	3	0.5
	Construction	2	0.4
Sources of Financing*	Others	22	4
	Self-financing	453	82.2
	Family / Friends	129	23.6
	Bank & Microfinance loan	67	12.2
	Money lender	22	4
	Suppliers	17	3.1
	Ar-Rahnu / Pawnshop	16	2.9
	Donation / Zakat	2	0.4

\* Borrowers have multiple sourcing of financing

Most of the entrepreneurs run their businesses on a full-time basis and earn RM1,500 to RM5,000 monthly. Some of them (12.4 per cent) earn more than RM5,000 per month. Hence, quite a number of the entrepreneurs (13.2 per cent) who earn less than RM1,500 per month are considered as the vulnerable group who are struggling to make their businesses survive.

More than half of the respondents carry out trading business activities such as buying and selling, being distributors, or vendors. Meanwhile, 25 per cent of them run service related business activities such as tailoring, catering, operating a laundry, or a massage centre. Another 17.4 per cent are involved in manufacturing activities either in food processing or furniture making. Only a small number of them are engaged in agriculture as the survey was conducted in the urban area.

It was also found that a majority of them are self-financed (82.2 per cent), followed by borrowing from family and friends (23.6 per cent), and from banks and microfinance institutions (12.2 per cent). A small number of microenterprises (4 per cent) received loans from informal money lenders or “loan sharks” to finance their businesses because here, applying and approvals of fund are easy and very quick. However, these informal lenders are usually operating outside the legal provision of lending and offer clients loans of various amounts at exorbitant interest rates.

### 3.3 Challenges and Expectations of Microentrepreneurs

Microentrepreneurs face several challenges (Table 3). They face difficulties in penetrating the market, promoting their products, and being competitive with other established entrepreneurs. This is also due to their small capital. They need more capital in order to stay competitive in the market as well as for the expansion of the business. They also need other services such as access to market information, assistance in improving their products in terms of packaging and branding, technical assistance for better product quality, etc.

Table 3. Challenges and Expectations of the sample microentrepreneurs

	Business Status	No of Respondents	(%)
Challenges of Business	Demand for products	348	23.2
	Capital	340	22.7
	Competition	333	22.2
	Workers	246	16.4
	Skill	132	8.8
	Support from government	61	4.1
	Support from family	26	1.7
	Other (Specify)	13	0.9
Required Supports	Capital	317	39.1
	Access to market service	126	15.6
	Outreach service	89	11
	Aid to improve product	87	10.7
	Training and technical assistance	85	10.5
	Assistance development	53	6.5
	Financial literacy and education	52	6.4
	Other (Specify)	3	0.1
Future Plan	Expand the business	359	63.7
	Change business	26	4.6
	Change location	23	4.1
	Shut Down business	13	2.3
	No plan	140	25.3

In spite of the several challenges, most entrepreneurs (63.7 per cent) are very optimistic and they plan to expand their businesses (Table 3). About a quarter of them are contented with what they are doing as they do not plan to do anything extra in the very near future. Around 11 per cent of the respondents are struggling and would like to shift or shut down the business.

Table 4. Perception of microentrepreneurs about microfinance borrowing

Perception of Microentrepreneurs		Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	Mean
		Frequencies (%)					
Microfinance Non-borrowers	Afraid to have debt	132	202	94	47	9	3.83
		27%	42%	19%	10%	2%	
	No need for credit	54	143	183	90	14	3.28
		11%	30%	38%	19%	3%	
	Business is too weak to run a credit	27	129	183	108	37	3
		6%	27%	38%	22%	8%	
Microfinance Borrowers	The current loan is not adequate	3	29	23	11	1	3.34
		5%	43%	35%	16%	1%	
	Have the ability to pay back on time	12	41	12	2	0	3.94
		19%	61%	17%	4%	0%	

Most of the microfinance non-recipients (mean 3.83) agreed that they did not borrow credit because they are afraid to become indebted. In addition, a majority of them (mean 3.28) believe that they do not need the credit. However, only 32 per cent agreed that their businesses are too weak to accommodate credit. Moreover, among the microfinance recipients, only 17 per cent mentioned that their current size of credit is enough, which means that the rest of the microentrepreneurs still have scope to take more credit. Among the current borrowers, only 3.7 per cent do not have the ability to pay back the credit on time, which means that most of them are competent with the ability to repay the credit.

### 3.4 Estimation of Potential Market Size

The Central Bank of Malaysia (Bank Negara Malaysia) has a provision for small business loans of up to RM50,000 (USD15,800) for business activities by microenterprises (Bank Negara Malaysia Annual Report, 2012). According to the records of the Department of Statistics, the number of total registered SMEs in Selangor is 125,904 and out of that, 74.4 per cent or 93,673 are microenterprises (National SME Development Council, 2013).

Our survey result shows that 76 per cent of the microenterprises are registered (Table 5). Therefore, the estimated total microenterprises would be  $(93,673 / 76 \text{ per cent}) = 123,254$ . Among the total microenterprises, 50 per cent have potential for microfinance loan (Gazy, 2005; Ayayi & Yusupov, 2012); therefore, the total potential microenterprises are 61,627. Among them, 9.5 per cent already receive microfinance; thus, the rest are potential clients at around 55,772 microenterprises.

Table 5. Estimation of market size for microfinance in Selangor, Malaysia

	Registered SME	Registered Microenterprise	Estimated Total Microenterprise	Estimated Total Borrowers	Estimated Potential Borrowers
Considering Unregistered as 24%	125,904	93,673	123,253	61,627	55,772
Considering Unregistered as 1/3 or 33%	125,904	93,673	283,856	141,928	128,445
Considering Unregistered as 3/4 or 75%	125,904	93,673	124,897	62,448	56,516

Estimation by the World Bank indicates that among all of the establishments, informal are between  $\frac{1}{3}$  to  $\frac{3}{4}$  (Nawai & Shariff, 2011). Based on this assumption, here the estimated potential microenterprises would be 124,897 to 283,856 (33.3 per cent to 75 per cent of 93,673) (Table 5). Among the total microenterprises, 50 per cent have potential for microfinance loan (Gazy, 2005; Ayayi & Yusupov, 2012); therefore, total potential microenterprises are 62,448 to 141,928. Among them, 9.5 per cent already receive microfinance, which means that potential clients are around 56,516 to 128,445 microenterprises in Selangor, Malaysia.

### 4. Conclusions and Recommendations

The study found that only 9.5 per cent of the microenterprises received microfinance credits in Selangor, Malaysia, therefore a vast proportion of microentrepreneurs in Malaysia still have potential to receive microfinance credit. The estimated size of the potential microenterprises varies based on different assumptions. Overall, the range of the potential market size for microfinance is 55,000-128,000 microenterprises in Selangor, Malaysia.

There are several reasons for the small number of microfinance borrowers among the microenterprises. Most of the microentrepreneurs only rely on self-financing or financing from family and friends. Many of the entrepreneurs are part-timers who already have some sort of savings or have been saving for the expansion of their businesses. Some of them seek help from relatives, friends, or neighbours because they would expect them to return the favour sometime in the future, as a gesture of a reciprocal obligation. Moreover, most of them do not want to be involved with credit and be trapped in the cycle of interest. Further, many of them feel that the frequent loan payment is too burdensome because most of the microfinance institutions require a weekly repayment, while in the case of family members or friends, immediate repayment is not needed. They also lack confidence in growing their business and think that their businesses are not strong enough; therefore, they fear that they might lose what they have now.

Overall, most of the microentrepreneurs had negative perceptions about the loans though they agreed that *Shariah* compliant products are easily available in the market, and they have to change in order to progress with more capital. Therefore, the MFIs must take initiatives to promote microfinance among the potential microentrepreneurs so that they can maximize their outreach among the existing microentrepreneurs.

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