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A Case for a *Shari'ah* Compliant Alternate Credit System to Facilitate Working Capital Management for Micro, Small and Medium Enterprises in Malaysia

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Abstract

Studies and statistics have shown that micro, small and medium enterprises (MSMEs) enhance competition through economy-wide entrepreneurship, encouraging innovation and improving efficiency as their industries grow. In an increasingly globalized marketplace, it is important for Malaysian MSMEs to remain competitive in order to survive. Due to their size, they face many problems with regards to business operations. One of the main problems is access to financing for working capital management. This paper seeks to identify the main problems faced by Malaysian MSMEs in raising finance to meet their working capital requirements in their business operations, and also delve into the concept of trade credit and its employment in MSME business practices. Finally, the elements of an alternative strategy of working capital management will be proposed and discussed for the betterment of the MSMEs in Malaysia.

Keywords: SMEs, Working Capital Management, Trade Credit

1. Introduction

There is growing recognition of Micro, Small and Medium Enterprises (MSMEs) as important contributors to the economic development in the modern economy. In almost every economy, MSMEs have been singled out as the sole contributors to the private sector; also, they have served the society towards a greater social equity by alleviating poverty, fostering innovation, creating employment, and boosting productivity of physical, human and financial resources (Pletnev & Barkhatov, 2016). More often than not, MSMEs are described as source of innovation and employment, the seeds of several big businesses, the fuel of national economic engines, and their dynamic relationship of interdependence with larger firms, even in the developed industrial economies (Ackah & Vuvor, 2011; Audretsch, 2002).

In fact, there is almost no doubt on the essentiality of the presence of MSMEs in any economy as they heavily contribute to the economic development (Khan & Khalique, 2014; Nikolaeva & Pletnev, 2016). As a result of their contributions to the national development, working capital management of MSMEs, one germane to this research, have drawn the attention of both academician and practitioners

Being the unit of study, literature has emphasised the importance of MSMEs as perfectly dominant in the national business structure and contributors to the Malaysian economic development (Maarof & Mahmud, 2016). In 2017, MSMEs contributed approximately 37 percent to the national Gross Domestic Product (GDP), provided more than 65 percent job opportunities, and accounted for 98.5 percent of total number of firms in 2013 (Maarof & Mahmud, 2016; SME Corporation, 2017). Moreover, Thut (2011) notes that MSMEs account for 97.3 percent of the total business registered in Malaysia, employing over 3.6 million employees nationally.

While MSMEs are recognised as the main economic engines, they are however facing several challenges that are particularly limiting their potential. Some the problems facing them, according to Sallem, Nasir, Nori and Kassim (2017), are access to finance for working capital purposes, lack of accounting knowledge, lack of information technology usage (ICT), lack of proper record keeping, and limited financial resources. Of the above challenges, management of working capital, the main area of this study, remains crucial for MSMEs since they need to achieve high profitability without any exposures to liquidity problem (Yunos, Nazaruddin, AbdolGhapar, Ahmad, & Zakaria, 2015).

Moreover, MSMEs are required to pay close attention to their working capital management because the following reasons: current assets constitute most of their total assets, current liabilities are the most important aspect of their external funding, they are more risky compared to large firms and this makes it difficult for them to secure long-term funding, threatening their long-term growth, profitability, and survival (García-Teruel & Martínez-Solano, 2007; Lyngstadaas & Berg, 2016). Since many MSMEs have government entities or large companies as their buyers and these entities take some time to honour their before paying their dues, keeping certain level of investment in working capital is required to finance business operations, especially to carry out purchases, productions, selling goods and services (Baker et al., 2017).

Although the above claim might be true in the case of large firm with strong cash positions and that are more likely to obtain cash from formal financial position in this region; however, such claim may be lost for the managers and owners of MSMEs, who are focusing on ensuring liquidity and offering generous trade credit to their customers in order overcome stiff competition. Without prejudice to some MSMEs with successful actions to ensure prompt payment; several MSMEs, until it begins to turn sour, are unfortunately treating credit as a commercial matter to their customers, rather than as financial matter.

In Malaysia, access financing by MSMEs is never an easy task as many have get their loan applications rejected by the formal banks. Although there are alternative financing options, such as loan sharks mentioned above, invoice financing, crowdfunding, or something else, for SMEs; business loan from formal banks remained the first choice for many managers and owners of SMEs. Based on the Bank Negara Malaysia's "Key Statistics on SME Financing and *Pembiayaan Mikro* by Financial Institutions," the average approval for MSMEs loan application in 2017 by the Malaysian' banks are 33.4 percent; though the approval rate varies from sector to sector, but what determines MSMEs' loan approval such things, like financial strength, company's credit score, and background (BNM, 2018).

Given the aforementioned issues, the researcher deemed it necessary to propose an effective innovative money idea that are *Shari'ah* compliant to provide permanent solutions to the MSMEs financing issues. As such, the researcher offers a conceptual strategy to ensure the availability of credit to finance short-term liabilities of MSMEs and to enable the constant circulation of credit which will have a multiplier effect in promoting trade, increasing profitability, and boosting employment of both physical and human resources.

The main purpose of this study is to investigate the problems facing MSMEs in raising financing for their working capital requirements, and to identify conceptual elements to a solution to MSMEs working capital financing problems using innovative money ideas that are *Shari'ah* compliant, fast, and cheap.

2. Literature Review

In the case of Malaysia, the enterprises are first demarcated according to specified industries before being classified as a micro, small or medium enterprise based on their number of full-time employees employed or their annual sales turnover, with distinct benchmarks for each industry. A snapshot of the current categorization and classification criteria used is shown in Table 1 below.

Table 1: Classification of SMEs in Malaysia effective Jan 1, 2014

	Micro Enterprise	**Small Enterprise**	**Medium Enterprise**
Manufacturing	Sales turnover of less than RM 300,000 OR employees of less than 5	Sales turnover from RM 300,000 to RM15 million OR employees from 5 to 75	Sales turnover from RM15 million to RM50 million OR employees from 75 to 200

Services and other sectors	Sales turnover of less than RM 300,000 OR employees of less than 5	Sales turnover from RM 300,000 to RM3 million OR employees from 5 to less than 30	Sales turnover from RM3 million to RM20 million OR employees from 30 to 75

Source: SME Corporation Malaysia

Current literature on SMEs in Malaysia are usually focused on the general development of SMEs, issues and challenges faced by SMEs, the availability and development of MSME financing products, and the sources and uses of funds. Studies have found that Malaysian SMEs face the following challenges in increasing their competitiveness, failing which can cause them to go out of business: lack of access to financing, low productivity and human resource constraints, limited managerial capabilities, limited adoption of technology, lack of information on potential markets among others. (Wan, 2003; Ting, 2004)

Studies by Aris (2007) and Chee (1986) have proven that the main challenges impeding SMEs access to financing were lack of collateral, lack of relevant financial records, failure to provide sufficient documentation for loan applications and the lack of a performance record to assess viability of the business. Aris (2007) also listed the slow loan processes as a constraint on SMEs.

Abdullah & Manan (2007) conducted a study on 201 small business in the Klang Valley to determine the availability, accessibility and adequacy of financial facilities for small businesses in Malaysia. Their study revealed that many small businesses did not gain adequate financial assistance despite the abundance of dedicated support facilities for SMEs, and that accessibility and adequacy of these funds were limited and fragmented across the SME industries.

Saleh and Ndubisi (2006) observed that Malaysian SMEs had difficulty in obtaining financing from financial institutions and governments, and that the interest rates charged on these loans were prohibitive.

Muhammad et al. (2011) also examined the availability and accessibility of financing for SME business development by surveying 124 SMEs located in North Malaysia. Major problems faced by the SMEs studied included insufficient working capital, increased interest rates and service charges, complicated loan application procedures and slow processing time. Interestingly, they also found that there was a certain lack of awareness of the dedicated government programs for SMEs, consistent with Abdullah & Manan (2007), and that previous rejections of applications served as a deterrent from further pursuing such avenues. As such, SMEs preferred to deal with their local commercial bank only for their daily operations due to less stringency and better accessibility in financial facilities provided.

3. Methodology

Given that the purpose of this study is to identify MSME access to funding and working capital financing issues in Malaysia, the researcher has chosen one of the probability sampling – stratified sampling. In this case, MSMEs were first identified according to their industries, and they were chosen based on the proportion of their industry to the whole. This method was expected to provide a more accurate representation of the population of MSMEs in Klang Valley since some industries may be more concentrated than others in the region. Stratified data on the types of industries operating in the Klang Valley were obtained from the SMECorp annual report.

Moreover, as financial data of some MSMEs are not publicly unavailable because many of them are yet to be listed on the Kuala Lumpur Stock Exchange (KLSE, also known as Bursa Malaysia); this provided a challenge to perform quantitative analysis on their performance and efficiency. Therefore, questionnaires were sent out to MSMEs located in the Klang Valley of Malaysia, across different sizes and industries.

The target population for the present study are MSMEs owners and managers in Klang Valley, Malaysia. These respondents were selected because of their direct involvement in the MSMEs' working capital management. Therefore, the researcher collected data for this study from the owner and managers of MSMEs in Klang Valley, Malaysia

As for the selection unit of study in Malaysia – Klang Valley; the Klang Valley region, consisting of Selangor and Kuala Lumpur, accounted for nearly one-third of the total SMEs in Malaysia, according to the

SMECorp 2012 annual report. This is followed by Johor with 10.7 pand Perak with 9.3 percent. Therefore, this research targeted MSMEs located in the Klang Valley region, as the concentration of business and the number of banking and financial institutions are high in this area, enabling us to gain a proper understanding of the SME financing behaviour in the midst of all these facilities.

The sample size for this study consist of 164 owners and managers of MSMEs in Klang Valley region of Malaysia. Initially, 250 questionnaires were sent to almost all the MSMEs identified in the study's location; 175 questionnaires were returned and 164 of duly completed are used for this study. The researcher was able to perform relevant analyses on the data collected from the owners and managers of MSMEs in Klang Valley, Malaysia. During the analyses, the responses were categorised and cross-tabulated accordingly, and descriptive statistics was used to summarize data in an informative manner, mostly breaking down variables and sorting them into certain general classifications.

4. Results

In this section, the researcher will describe the main characteristics of the MSMEs that have been sampled, with an insight into their working capital management techniques and issues faced. The results described in this section can provide a broad overview of the nature of MSME operations, and also provide a context for the trade credit practices of these firms. For each characteristic described, a brief discussion will be provided to provide some perspective.

4.1 Size

The survey was specifically targeted for MSMEs in the Klang valley. From the survey, it can be seen that 21 % of the establishments were classified as micro-sized enterprises, 59 % were in the small-sized category and about 18% were medium sized firms. This allows for good representation of micro and small sized businesses. With regards to the ownership structure, only 16% of the sample were sole proprietorships. 33% were general partnerships, and 15% were family owned businesses. Interestingly, about 33% of the firms are listed on the stock market and are owned by shareholders.

4.2 Activity

Business practices vary across industries. From the respondents, it can be seen that 24% of the firms were involved in wholesale and retail trade. This represented the majority. From the remaining, 20% of the firms were in the services industry, 18% were providing manufacturing-related services, 16% were involved in primary agriculture and 12% are in the information and communication technology (ICT) industry. Manufacturing firms were the least represented at 8%. From the initial result breakdown, two interesting observations can be made. Firstly, there is a good representation across different industries in our sample, allowing for proper generalisation. Secondly, it can be seen that MSMEs prefer to be involved in industries that do not require high capital expenditures and overhead expenses.

4.3 Age of Firm

With regards to the age of the business, 8% of the firms were operating for less than two years. The majority of the sample, namely about 46% of the firms, have been in operation for a period in between two and five years, and 37% of the firms have are aged between five and 10 years. This result illustrates a good amount of longevity and sustainability among the MSMEs, especially when a cumulative 91% of the firms have been in operation for 2 years and longer.

As there is no accurate measure to the success rate of MSMEs in Malaysia, Jebna and Baharudin (2013) have found that only about 13% of entrepreneurs folded their businesses after five years of operation, and that the expected failure rate is around 60%. However, in this study, we only focus on the businesses that are still in operation, and thus this study may not be able to confirm the failure rates of MSMEs.

4.4 Most Pressing Problem Faced by MSMEs

When enquired about the most pressing problem that their firms are currently facing, the majority, 24% of the firms, cited access to finance as the main issue. 23% of the firms listed heavy competition from peers as their most pressing problem, and 19% cited production and labour costs. These three causes combined make up for about two-thirds of the observations and may have an impact on the working capital management style of the firms and the trade credit practices.

The remaining firms reported other issues as their most pressing problems. 14% of the firms had major problems with the availability of skilled staff and experienced managers, and 12% of the firms mentioned marketing issues as their major problems.

4.5 Income Generation Indicators

Several factors were identified as relevant to the income generation and capacity of the MSMEs, namely trends in sales turnover, net interest expenses, profits earned, liabilities and total debt, usage of bank loans and trade credit. The respondents were asked to provide their views on the trends of these indicators in the past 12 months.

96% of the firms have witnessed an increase in sales turnover in the past 12 months, indicating growing revenue for their respective businesses. This is a very positive indicator to the operations of the business.

In addition, 92% of the firms also reported an increase in net interest expenses, which is defined in this study as the amount of interest payments paid by the firm over the any interest income received by the firms. Interest income earned is usually on the cash deposits owned by the MSMEs. In this exercise, we also treated those who sourced financing from and deposited cash with Islamic banks in the same vein as that of conventional banks.

When asked about profits earned, 72% of the firms reported increased profits over the past 12 months, and around 20% reported no change in profit levels. This too can serve as a very positive indicator to the operations of the business.

Interestingly, when observing indicators related to the liabilities of the firms, significantly lower increases can be seen. Only 52% of the respondents reported an increase in the total debt of the firm, compared to 40% who reported no change. However, acknowledging no change in the liability of the firm may not indicate that current levels are low and sustainable.

47% of the MSMEs reported an increase in usage of bank loans, whereas 39% reported no change. For the purpose of this study, the respondents were asked of only increase in usage of bank loans, which indicates more loans taken during the past year. One possible reason for the high percentage who reported no change could be due to the term periods of existing loans which were still being serviced by the firm's management. As a receiver of trade credit, 53% of the firms reported an increase of trade credit received, as compared to 35% of no changes in trade credit.

4.6 Sources of Finance

In an attempt to understand the financing structures and behaviours of MSMEs, the respondents were asked if they had used different sources of finance/financing in the past 12 months. Eight types of financing options were presented, within which specific amounts and details were not enquired upon.

With reference to internal funding, 87% of the respondents affirmed that they had indeed used internal funds to finance their operations. Internal funding in this context refers to the manager's own wealth and savings that were not previously allocated as firm capital.

With regards to financial assistance from government agencies, 79% of the respondents cited acquisition of funds from these channels for use in the business. However, it is not specific as to the nature of the grants or loans obtained. They could be one-off welfare payments provided by the government, or a line of financing from an agency dedicated for the development of SMEs. Therefore, for discussion sake, we include any payments or funds received from the government through any channel that were used for business operations.

With respect to bank financing, 70% of the respondents reported to have used bank overdrafts, and 64% took bank loans for financing. Only 16% did not use any bank overdraft facilities, and 15% did not take a bank loan. A cumulative total of 34% mentioned that they did not know if the firm resorted to bank financing, or if it was applicable to their firm.

In terms of trade credit usage, 56% of the respondents stated to having used trade credit within their business transactions, and 21% reported to not using it at all. In this case, all types of trade credit were considered without bias.

Personal loans can be acquired through informal lending channels such as family, friends and moneylenders. This type of loans usually are not recorded nor regulated, and the costs of financing depend on the nature of the relationship between the borrower and lender. When asked about financing from such sources, 51% of the respondents admitted to having sought financing from family and friends, and 46% reported making use of facilities by moneylenders. In contrast, 27% reported not having borrowed from family and friends, and around 30% reported not approaching moneylenders.

4.7 Impact of Working Capital on External Financing

When asked on the impact of working capital needs on external financing, only 13% of the firms reported that there was an increased need, and 51% mentioned that there was no impact on needs for external financing. One possible conclusion could be that over half the firms are employing good working capital management techniques to ensure that there is sufficient liquidity to cover obligations. Alternately, this can also mean that these MSMEs may be employing very conservative strategies to avoid any risk, leading them keep more funds in reserve for working capital needs, at an opportunity cost of increased production and business.

4.8 Outcome of Application for Bank Loan And Government Assistance

When asked about application for bank loans in the past year, only 2% of the firms got the entire amount of desired financing from the bank. 33% of the firms had applied and received a partial amount. However, around 55% of the firms had successful applications for bank loans, but refused to accept it due to the high costs of financing. Only 5% of the firms reported rejected applications from the bank.

This indicates that the acceptance rate for bank loan applications is rather high, and that banks are indeed entertaining requests from MSMEs. However, only 2% of the firms received the entire amount desired. The reluctance of over half the MSMEs to accept the terms of the loans due to high costs indicates a huge opportunity for cheaper financing alternatives.

When asked about applications to dedicated government agencies for financing, only 4% of the firms obtained the desired amount of financing. 31% of the firms managed to obtain a partial amount of the requested total. Interestingly, as seen with bank loan applications, around 54% applied and refused the financing opportunity due to perceived high costs. 5% of the firms applied and were rejected.

This shows that the outcome of applications to governmental agencies is somewhat similar to bank loan applications. The government has set up several dedicated agencies to provide funding and assistance to MSMEs across the country, in order to boost the industry. The results from this survey indicate that over half the MSMEs perceived these channels as being expensive as well.

Some of the firms chose not to pursue external financing in the past year of operation. Upon enquiry, it was found that 65% of the firms did not apply due to sufficient internal funds. 10% of them did not apply due to fear of possible rejection, and 20% of them did not apply due to other reasons. In this case, sufficient internal funds could mean idle cash reserves, which have been kept for bad times. Non-utilisation of these funds could provide an indication of risk averseness of the managers, which can signal unutilised production capacity due to fear of credit crunch.

4.9 Trends of Terms and Conditions of Bank Financing

As bank financing is the most preferred and popular method of financing for both short term and long term, the respondents were asked about the terms and conditions set out by the bank for them when financing was sought, and if they were increased by the bank, remained unchanged or decreased by the bank. The factors that were explored in this question are level of interest rates, level of cost of financing other than interest rates (charges, fees, commission), available size of loan, available maturity of the loan, collateral requirements and time required for loan approval.

When asked about interest rates, 93% of the respondents reported an increase in the overall level of rates offered to them. None reported any decrease in any form. In addition to level of interest rates, 88% also reported increase in other related costs of financing such as charges, fees and commissions incurred. Only 7% reported no change in these costs

When asked about the available loan size and credit line offered, 58% reported an increase by the bank, whereas 34% cited no change. In addition, 42% cited increase in the available maturity of the loan while 47% reported no change. The available size and maturity are both terms that are dependent on the MSME profile, the requirements of financing, and many other factors like relationship with the respondent, collateral used and general economic conditions (Wang, 2016).

When asked about the collateral requirements usually stipulated by the banks prior to providing financing, 47% of the respondents agreed that they had been increased by the bank, whereas 38% reported no change. On the trend of time required to obtain loan approval, 47% of the respondents reported an increase by the banks, and 36% reported no change. This could be due to the improvement of due diligence standards employed by banks to evaluate loan applications, as a result of regulatory requirements and prevailing economic climate.

4.10 Factors to Availability of External Financing

Availability of external financing can depend on several factors, which are both macro and micro in nature. This can depend on how the external sources of financing may view at the performance of the firm, and also the general state of the economy as a whole. The factors explored in this question are general economic outlook by firms, access to public financial support, firm's capital, firm's credit history, willingness of banks to provide loan, and willingness of business partners to provide trade credit.

When the respondents were asked about their views on the general economic outlook over the past year, 79% of them believed that there was an improvement while 15% sensed no change. This was corroborated also with the following question, whereby around 77% of the respondents felt that there is also an improved and easier access to public financial support.

When asked about the firm's capital and credit history, 55% of the respondents mentioned an improvement in the firm's capital and 37% reported an improvement in the credit history. 33% cited no visible change to the firm's capital, and 48% reported unchanged trends in the firm's credit history. Less than 10% reported any deterioration to both indicators.

With the context of the general economic outlook and the firm's credit profile, the respondents were asked on the general trend of bank's willingness to provide loans to them. Only 39% mentioned that there was an improvement and that banks were more willing, whereas 46% reported no change in behaviour. The lack of change in this particular trend may not be bad news, especially if banks have been aggressively pursuing this segment of the economy due to the higher rates that could be levied upon them.

In contrast, 41% of the respondents have reported an increased willingness of business partners to extend trade credit over the same time period, while 44% reported no change. This is somewhat expected as many of the firms deal only on a cash-on-delivery basis.

4.11 Size of Last Loan and Usage

When asked about the size of the last loan obtained by the firm in the past 12 months, 31% of the firm managers cited that they did not take a loan. However, 56% of the firms did take a loan of some sort, but the amount is smaller than RM 25,000. At the other end of the scale, only 13% of the firms obtained a loan of above RM 25,000.

Of those who had taken a loan, 77% of those who obtained loans got it from banks, and 20% of them obtained it from private individuals. Private individuals may include friends, family and moneylenders. Only 3% obtained this financing from other sources such as government agencies and microfinance institutions

The survey then went on to enquire on the usage of the last loan obtained. The respondents were allowed to choose more than one answer to help us identify main areas of usage. The major uses of these loans were for promotion and marketing purposes. The loans were also mainly used for Research and development, financing and acquisition of buildings and vehicles, training of staff and employees, and for working capital purposes.

With regards to the aim of this research, only 26% of the firms mentioned using the loan for working capital purposes. As implied in the previous paragraphs, it could either mean an efficient working capital management policy, or a conservative approach to risk management where these firms prefer to hold idle amounts of cash unutilised for contingency purposes.

4.12 Average Employment Growth and Turnover Growth

MSMEs are said to contribute to the employment rate in an economy. From this study, 35% of the MSME managers reported a growth of over 20% per year in employment of full-time (and its equivalents) employees for the last three years. 48% of the firms reported a growth of less than 20%, but a growth nonetheless. 7% of the firms reported no growth, and 6% reported a downsizing in their workforce.

According to the Department of Statistics Malaysia website, the national employment growth rate for the same time period was about 3.57%**.** The results indicate that the MSMEs manage to outperform national employment growth rate, illustrating on how integral this sector is towards providing employment to the citizens of Malaysia.

Also, over the last three years of operation, 45% of the firms reported an average turnover growth exceeding 20% per year, whereas 38% of the MSMEs reported growth, but at under 20% annually, and 7% of the firms reported no turnover growth. The high growths indicated may be so due to the small amount of turnover, and not in absolute ringgit or dollar terms.

In contrast, the GDP growth rate for the Malaysia in the same period is estimated to be about 5.6%. This shows a lot of opportunity for growth within the MSME segments, and boosting their businesses can lead to a significant increase in national GDP.

4.13 Preferred External Financing Channel and Limitations

In order to fulfil their growth ambitions, 84% of the MSME managers indicated that they would prefer to obtain the required funds through bank loans, and 9% reported taking loans from other sources.

One reason as to why bank loans may be preferred is due to their safe nature and it being the common practice of the land. Another reason is probably to retain control over the business by not allowing additional shareholders or giving up an equity stake. Also, as many of them are small business owners, they may not be too aware of the other available avenues for them to raise financing, and may fall back onto bank loans due to their familiarity.

On the query of amount of financing desired by MSME managers, 64% of the managers just need financing of less than RM 25,000 and one third of them aim to obtain an amount between RM 25,000 and RM 100,000. Only around 4% desired a financing amount of above RM 100,000.

This shows that managers do not need a large amount to finance their business needs at that point in time. These financing needs also depend on the size of the firms, and the stage of the growth cycle at which their businesses are currently in.

When asked about the most limiting factor faced by the MSME managers to obtain their desired amount of financing from their preferred channel, 38% cited the lack of collateral and guarantees as the main reason. The second major reason cited was the high costs of interest rates.

Interestingly, about 19% of the respondents mentioned that they did not see any obstacles to obtain the desired financing, and this could be partly due to their risk adversity to seek growth through leverage. This reason can be corroborated with the result that 13% of the managers cited that the potential reduced control of the firm was their main limitation to obtain their desired financing.

4.14 Credit Terms

Upon enquiry of the types of trade credit offered by the MSMEs to their customers, the responses obtained indicate an interesting result. Almost half of the respondents, about 49.40% of them, do not offer trade credit of any type and demand Cash-on-Delivery (COD) from their customers.

The second most popular credit term offered is a 30-day grace period to settle invoices, with about 24%

of the respondents offering such terms. Around 10% of the respondents offer 10 days term period of credit. Other credit terms that are offered vary across periods between 7 days and 30 days, depending on the nature of the business and the relationship with their customers.

Another interesting finding from the survey is that the offering of discounts within the trade credit term is not prevalent, and that the amount quoted is to be repaid as it is. Since about half the MSMEs do not offer trade credit and demand cash payments upon delivery, it illustrates the non-willingness of these enterprises to take risks, and also possibly the cash-intensiveness of the business.

An initial observation from the trade credit terms often quoted by both suppliers and receivers of trade credit reveal somewhat similar trends. The most common terms quoted is no trade credit, or cash-on-delivery. This entails that the purchaser must pay cash upon delivery, and requires businesses to often ensure sufficient liquidity to meet needs.

As most of the businesses surveyed are of small size, it may mean that they lack the market power, or bargaining power to dictate demands or terms of trade. As such, they are mostly subjected to cash-on-delivery terms.

The second most popular trade credit term is 30 days. Although those who provide this option do so at a net basis, viz without discount, some businesses do offer/receive discount at the discretion of the counterparty. 30 days trade credit term is the second most popular terms of trade that was found within our respondents, who are both receivers and givers of trade credit.

The third most popular term, both on those who offer or receive trade credit, is 10 days net term, where the counterparty is given 10 days to pay in full. As with the previous term, though there is no discount offered, but certain suppliers and customers do avail a discretionary discount in case of early payment at the discretion of the one who offers.

In the case of those who are offering trade credit, credit terms that were also used are 14 days, 18 days, 7 days and 25 days. In the case of those who are receiving trade credit, the common terms quoted to them are 14 days and 3 days.

In contrast with trade credit terms, which are commonly quoted in other countries, there is almost a lack of trade credit discounts that are observed here, at least in the explicit sense. From the interactions with the respondents, it was observed that discounts were fully factored into the final price quoted in some cases, possibly due to price discrimination strategies by the suppliers. Some of the respondents also indicated giving or receiving trade credit on a discretionary basis, and also offering discounts in kind, instead of in monetary terms.

5. A Conceptual Solution

From previous studies aforementioned, it can be seen that MSMEs face major hindrances in access to finance for working capital needs arising from usage of trade credit and late payments. Though trade credit may seem like a practical, perceivably expensive, mechanism for trade in the absence of funds, improper matching of payables and receivables may lead to a liquidity gap, and ultimately business failure.

Therefore, there is a need of an alternative credit payment and clearing system that will allow MSMEs to have easier access to financing, even with the absence of collateral, financial records, performance records and other documents. The system should help MSMEs overcome the main barriers cited as impedance to obtaining financing, and provide a safe, secure and practical solution to all parties involved.

The proposed concept involves the setup of a specialised credit clearing system, which is to be utilised within a network of MSMEs, corporations and banks. An appropriate asset should be identified to be used as a tool, which will be used to back the credits that will be issued and circulated within the network through amongst the members. Such an asset will have to have real value that is measurable, divisible, easily recognised and transferable. The maturity of the credits will be dependent on the asset upon which it is backed, and it should be issued at zero interest rate, in order to enhance circulation. These credits can be used for settling payments and debts among other participants in the network, and should be also convertible into national currency if it is to be utilised outside the network. This study proposes the use of trade credit as the asset that backs the credits, as it is denominated in the national currency at usually standardised terms.

This expected benefit of a specialised credit payment system is manifold. Firstly, it can facilitate growth on MSMEs in the country and also complement access to finance, by boosting liquidity through alternative credits in the absence of national currency. A major problem, which this system can solve is the issue of late payments. MSMEs will be able to pay their suppliers on time, and avail early payment discounts, by using these specialised credits as currency. In other words, MSMEs have an alternative payment method for their payables, without having to wait for their own customers to pay the receivables due. This helps enhance working capital management practices of the MSMEs, and these firms will be able to maximize utility of available resources, even when their access to formal financing channels are limited.

As studies have shown that lack of financial documentation by MSMEs have led to their loans being rejected, a fully functional payment system can help record transactions of the firms whenever these credits are issued and circulated, and this can be further developed into a monitoring technology for future credit evaluation of MSMEs. Payment behaviour and trade volumes of MSMEs can be tracked and recorded online with this system, which can then be compiled into performance records that can be used for credit ratings.

An important feature of this specialised credit payment system is that the credits are backed with an asset of value, and can always be redeemed. This can add credence to it being used as a method of payment. As MSMEs often bear high interest rates on their loans due to their risk profile, the interest-free feature of these credits can improve the cash balances of MSMEs, motivate circulation of these credits and prevent hoarding, as utilisation leads to creation of value to the firm.

A system that provides specialised credits, backed by an asset of value, can lead to increased trade and outputs, enhanced liquidity within MSMEs, and also encourage national employment. A fully functional electronic implementation of this system can help in recording and monitoring transactions within the network, and also generate relevant performance and financial records for creditworthiness evaluation. This can provide a better landscape for MSMEs to grow in their size and trades, and also allows for better financial inclusion.

In Malaysia, there is a growing demand for *Shari'ah* compliant financing products by businesses and individuals, and this is reflected by the growing number of Islamic financing schemes that are offered by banking institutions and government agencies to MSMEs. *Shari'ah* compliant financing schemes are on the rise due to growing demand by entrepreneurs who wish to conduct their business in accordance to their Muslim faith. Any strategy constructed should be modelled according to *Shari'ah* principles to enable participants to benefit from a *Shari'ah* compliant product, thus enhancing its marketability to MSME operators who wish to abide by Islamic principles in their conduct of business.

6. Conclusion

From the research, it was found that access to financing, heavy competition from peers and production and labour costs were the main pressing issues for MSMEs in the Klang Valley. These issues may have an impact on the working capital management style of the firms and their trade credit practices.

Despite successful applications of bank loans, the reluctance of over half the MSMEs to accept the terms of the loans due to high costs indicates a huge opportunity for cheaper financing alternatives. Almost half the MSMEs face working capital issues when their customers do not pay their dues on time, and around 54% of MSMEs have difficulty in collection of dues from their clients and customers. The results indicated that resources, such as time and possibly money would be wasted in receivables collection, and the risk of losing customers due to collection techniques. Usages of debt recovery services from debt collection firms represent a cost on the MSMEs, as they usually would have to transfer the debt at a discount to these firms.

As the Malaysian government seeks to spur development of MSMEs in the country with numerous financial and economic incentives, this study can contribute into understanding the financial and operational positions of MSMEs. However, the availability of such incentives may not necessarily mean that they are easily accessible, and that MSME owners are knowledgeable of them

Another recommendation of this research is to explore the *Shari'ah* element further within the proposed credit clearing system. One of the aspirations of Islamic Finance is *Maqasid Shari'ah*, which entails the preservation and promotion of *Shari'ah*, and also calls for the encouragement of good and prevention of evils. In this regard, it is in the interest of an Islamic economy to ensure that companies and individuals are conducting business and transacting amongst each other in a *halal* and *Shari'ah* compliant manner.

The scope of this study was limited to MSMEs operating in the Klang Valley region of Malaysia only. One limitation to this study is that MSME financing and trade credit behaviour is not examined in other regions, especially in semi-urban and rural areas where there may be significantly different behaviours and motivations upon the variables that are studied. It is hypothesised that interpersonal factors may play a larger role in MSME operations in rural areas, and further research can attempt to evaluate this hypothesis.

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