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Islamic Financing in Mitigating Access to Financing Problems of SMEs in Malaysia: A Survey Analysis

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Abstract: The SMEs worldwide face the biggest problem in accessing financial assistance. By surveying selected SMEs in Malaysia, this study found similar cases as they are also facing the same problem because of a lack of collateral. Investigating the feasibility of Islamic financing schemes in providing financial aids to SMEs, this study found that several Islamic financial schemes are preferred by SMEs depending on the risk profile of SMEs. These Islamic financial schemes can build a firm liaison with SMEs in realizing the *Maqasid al Shari'ah* and simultaneously offer paths to better distribute wealth and prosperity among SMEs and the funders as well. This study contributes significantly to the literature as it provides insights to the nature of the SMEs and the bridge built between the SMEs and the Islamic financing schemes as to realize the Islamic social financing aim as a whole.

Keywords: Islamic finance, Islamic financial schemes, Islamic social financing, financing patterns, SMEs

Abstrak: Industri Kecil dan Sederhana (IKS) di seluruh dunia mengalami masalah dalam mendapatkan bantuan kewangan. Hasil kajian yang telah dijalankan mendapati IKS di Malaysia turut mengalami masalah yang sama berikutan kekurangan cagaran. Dengan mengkaji keupayaan skim kewangan Islam dalam memberi pembiayaan kepada IKS, dapatan kajian menunjukkan

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bahawa beberapa skim kewangan Islam menjadi pilihan IKS bergantung kepada profil risiko IKS tersebut. Skim kewangan Islam ini boleh membentuk kerjasama yang kuat dengan IKS dalam merealisasikan *Maqasid al-Shari'ah* dan sekaligus menawarkan jalan terbaik untuk pengagihan pendapatan dan keuntungan antara IKS dan pemodal. Kajian ini menyumbang secara ketara kepada literatur kerana ia menunjukkan gambaran sebenar IKS dan hubungan antara IKS dan skim kewangan Islam demi merealisasikan tujuan kewangan sosial Islam secara keseluruhannya.

Kata kunci: Kewangan Islam, skim kewangan Islam, kewangan sosial Islam, corak kewangan, industry kecil dan sederhana

Introduction

Small and medium enterprises or SMEs are considered the engine of economic growth since they are a huge portion of the economic pie both in the developed and developing markets (Boocock & Shariff, 2005) and in terms of employment and intergenerational sustainability, as well as economic growth (World Bank-IDB, 2015). Access to financing and the ability to secure stable financial sources are the keys to the development, growth and competitiveness of SMEs (Cook, 2001; Hall, 2003). In Malaysia, SMEs contribute 35.9 percent of the total gross domestic product (GDP) and provide job opportunities to more than six million workers or 65 percent of the total employment (SME Annual Report, 2014/15). In the effort to support and ensure good growth and development of SMEs as the backbone of the economy, the government has allocated and spent a substantial amount of money in the form of loans, grants, guarantee schemes, venture capital and government loan schemes. Literature sees SMEs employing various financial sources to cater to their different needs throughout the different stages of the firms' lifecycle. For their initial start-up stage, most SMEs seek financing from internal sources, such as personal savings and retained profits (Wu et al., 2008) as well as from informal outside sources, like financial assistance from family and friends or angel financiers (Abouzeedan, 2003). They would then look for formal external sources like financial intermediaries such as banks and development institutions (Chittenden et al., 1996; Manan et al., 2011) for the next stages of their operations and expansions. The needs for financial assistance for the SMEs are determined by the different phases of the firms' lifecycle (Berger & Udell, 1998). Specific characteristics of SMEs, especially at their initial start-up stage, like informational opacity (Berger and Udell,1998), limited documentation on trading history (Cassar, 2004) and the high risk of failure (Huyghebaert et al., 2007), have forced SMEs to depend highly on internal funding methods.

The significant contribution of SMEs to the economic growth of a country and their reputation in generating employment and innovation cannot be denied and the obstacles facing them must be addressed urgently and efficiently. With regards to that, the Islamic Financial Institutions or the IFIs can play a part and extend their services, offering financial assistance as these IFIs can promote socio-economic justice and equitable distribution of wealth among the SMEs (Durani and Bocock, 2006). From this view point, providing financial assistance to SMEs by the IFIs is undoubtedly in line with Islamic principles (Chapra, 1992). A properly and well-designed economic development plan, reinforced by SME growth empowered by financing facilities from the IFIs could put both economic prosperity and social justice in place (Durani & Bocock, 2006).

Mac an Bhaird (2010) state that the realization of the significant economic contribution of SMEs has resulted in increased attention focused on the sector from policy makers as well as the academicians. Therefore, driven by the above, the objectives of this study is twofold; to examine and investigate the financing patterns of the SMEs in Malaysia and at the same time explore what Islamic Financial institutions (IFIs) can offer in mitigating access to financing problems facing the SMEs in Malaysia. A descriptive analysis is performed to describe the characteristics of the sample SMEs inclusive of the owner’s background, general information of the enterprises and their patterns of financing. A preference on the IFIs is also deduced from the analysis as to see which Islamic financial product is claimed to be the most suitable and accessible to the SMEs in financing their operations. This study contributes significantly to the literature by offering insights of the financing patterns of the SMEs and at the same time builds a liaison between the financing patterns and what IFIs can offer in mitigating the financing problem facing the SMEs in Malaysia, thus filling the gap in the literature.

The study proceeds with a literature review on the performance of SMEs in Malaysia and some neighbouring countries and a brief discussion on what IFIs can offer to the SMEs. The next section covers the data and methodology of the study which explains in detail the survey carried out and the descriptive analysis done. The results of the analysis is then laid out and discussed in the fourth section and the last section concludes the study.

The Performance of SMEs in Malaysia

SMEs, being a reputable sector in the economy, has consistently outperformed the overall local economy with the average annual growth rate of 6.8 percent, compared with 4.9 percent for the whole economy in the period 2004 to 2010 (SME Corp. Malaysia, 2012). Known to generate employment with 99.2 percent of the total business establishments, SMEs contribute 56.4 percent to the total employment in the country (Ministry of Finance, 2010), 31.4 per cent of GDP and 22 percent of the country exports (SME Corp. Malaysia, 2010). SMEs make 93.8 percent of the total companies in the manufacturing sector, contributing 27.3 percent to total manufacturing output and 25.8 percent to value-added production. They also own 27.6 percent of fixed assets and employ 38.9 percent of the country's workforce. In the manufacturing sector alone, the value-added products from SMEs is forecasted to be worth RM120 billion or 50 percent of the total production in the year 2020. This forecasted figure reinforces the significant contribution from the SMEs sector to the overall economy of the country. It is important to note that different countries have different definition of SMEs. This study uses the standardized definition of SMEs set by the National SME Development Council of Malaysia. The National SME Development Council has approved the definitions of SMEs which are based on two criteria (new definition of SMEs effective 1 January 2014), namely, number of full-time employees or annual sales turnover**.** For the manufacturing sector, the sales turnover should not exceed RM50 million or full-time employees not exceed 200 workers**.** As for services and other sectors, the sales turnover should not exceed RM20 million or full-time employees not exceed 75 workers. Therefore, an enterprise will be classified as SMEs if it meets either the specified number of employees or annual sales turnover definition.

The Financing Patterns and Problems of SMEs in the Region

Literature sees a monopoly of studies mainly on the financing patterns of SMEs in developed countries like the US and the UK, excluding studies covering the developing countries still insufficient and incomprehensive

(Haron & Ibrahim, 2016). Nonetheless, from the limited studies carried out, literature reports similar financing behaviours between SMEs in the developing countries comparative to those of developed countries (World Bank-IDB, 2015). Looking at the scenario in Malaysia in particular, the main constraints facing the SMEs in accessing financing sources are lack of collateral, insufficient documents to support loan application and lack of financial track (Aris, 2007; Abe et al., 2015). Failure in providing sufficient documentation to banks is the key reason for SME loan rejection (SME Annual Report, 2013/2014). Wahab and Buyong (2008) reveal that less than 20 percent of the respondents manage to secure financial assistance, leaving more than 80 percent face problems like short duration loans offered, insufficient amount of finance and difficulty in providing collateral to support the loan applications. Report on SME of 2014/2015 indicates that during the period of 2014, the approval rate for financing from financial institutions to SMEs is very much backed by collateral, i.e., property and fixed deposit. In addition, the findings also reveal that the majority of the respondents need financing for the purpose of purchasing raw materials as well as machinery and equipment.

The 2011 Malaysia Economic Census reported that most SMEs (55.9 percent) use their internal funding or use shareholders to finance their operations (Source: Department of Statistics Malaysia). About three quarters (75.6 percent) of SME financing was for working capital. The financing needs were similar across all sizes, namely, microenterprise (74.6 percent), small-sized firms (77.8 percent) and medium-sized firms (74.2 percent). Other main activities which required financing (43.6 percent) were for purchase and lease of equipment, machinery, vehicles, computer hardware and software as well as land and buildings. Manan et al. (2011) in their survey on Malaysian SMEs find that the most critical constraint that small and medium scale manufacturers mention is the lack of sufficient capital to operate the business. In most cases, businesses started using own savings and borrowing from friends and relatives followed by funding from banks.

In Malaysia, the non-availability of finance has been the most frequently cited problems encountered by SMEs, and it is also a crucial issue to many of them (see for examples, Zairani and Zaimah, 2013; Harvie et al., 2013; Darita et al., 2014; Wignaraja and Jinjarak, 2015; Haron, 2016). Most studies reported that majority of SMEs indicated inadequate working capital and lack of access to commercial lending as their major problem. Due to the nature of the SMEs, banking institutions remain the major provider of financing in many countries. Bank is a major source of SME financing in most countries. In Malaysia, banks provide 90 percent of total financing to SMEs (SME Annual Report, 2014/15). Private finance companies and family or friends come second after banks as another source of financing. Surprisingly, subsidized loan schemes under some government agencies and other similar institutions benefited only few, though the resources are abundantly available. It is important to note that sources of finance in Malaysia are actually abundant and is not a serious issue when discussing financing assistance for the SMEs. In 2014, for example, the government implemented 30 programs related to access financing (SME Annual Report, 2014/2015) undertaken by institutions like PUNB, Credit Guarantee Corporation (CGC), Amanah Ikhtiar Malaysia (AIM). What concerns the SMEs is the accessibility of the available funds (Abdullah & Manan, 2009; Ramlee & Berma, 2013; Abe et al., 2015).

Looking at the scenario in the neighbouring countries, James (1986) study on factors affecting financing patterns of SMEs in ASEAN (Malaysia, Indonesia, Philippine, Thailand and Singapore) reveals that more than 70 percent of SMEs in ASEAN on a whole use internal financing in the initial start-up stage. Indonesian SMEs seem to depend highly on trade credit extended by suppliers and cooperatives, not just during the initial stage, but also even in financing their operations. Contrastingly, however, SMEs in Malaysia and Singapore according to James rely mainly on bank credits. SMEs in the Philippines on the other hand, show a more colourful distribution of fund sources from obtaining credits from the government and the banks to informal sources such as family, relatives or even angel financiers. As for Thailand, the SMEs rely on informal funding sources which make up 40 percent of the total borrowing recorded. The financing patterns revealed from James (1986) confirm the use of informal financing by the SMEs in the region reflecting less popularity with bank credits. This is perhaps due to the strict terms and conditions imposed on the SMEs like the collateral requirement and documentation on trading history to support loan application. This earlier finding is further confirmed by Abe et al. (2015) on their studies on SMEs in Asia and the Pacific region. They conclude that although the various regions of the world differ significantly in their socio-economic characteristics, the fundamental financing difficulties that SMEs face around the globe are essentially similar. The ability of SMEs to develop, grow, sustain, and strengthen themselves is heavily determined by their capacity to access and manage finance.

Compared to large local firms and multinational corporations (MNCs), SMEs have more difficulty in accessing finance partly because their small size and lack of credit worthiness, due to the inefficiency of credit markets resulting from problems of asymmetric information (Behr et al., 2011). SMEs tend to face even greater difficulty in developing economies, where capital markets and regulatory frameworks are not fully developed, and financial systems tend to be dominated by banks, which is found to be associated with lower use of financial services by firms of all sizes (Beck et al.,2013). Using data from 2005, Shen et al. (2009) find that in the People's Republic of China (PRC), local proper lending authority, competition, credit schemes and law enforcement are supportive to loan provisions by commercial banks to SMEs. Harvie et al.'s (2013) study on a sample of 150 questionnaires collected in 2010 from Cambodia, Indonesia, Laos, the PRC, Malaysia, the Philippines, Thailand, and Vietnam, find that SMEs in these developing Asian economies tend to depend on internal finance for start-ups and business expansion. Banks are not willing to provide loans to small medium entrepreneurs as they present a high risk group. SMEs are not interested to borrow from banks due to the tight procedural process and the length of time it might take to obtain the loan.

The financing experiences of SMEs around the world suggest that smaller firms typically depend on internal finance for initial capital and external finance for liquidity, and studies have noted that banks are the major source of external finance. A survey, conducted under the World Bank Investment Climate for the period of 2002 to 2003 in 38 developing countries in Europe, Asia, Africa and Latin America, confirms the reliance of SMEs on internal finance and retained earnings. Arinaitwe (2006) finds that the SMEs have a lower level of external finance (debts over total assets) as a high proportion of their assets are financed primarily by family and friends (internal finance). Nonetheless, the comparative ratio of debt and equity indicates that debt was dominant over equity in the SMEs financial structure.

The Islamic Financing Assistance Offered by the IFIs

By putting emphasis on risk sharing and also collateral free for certain financial instruments, Islamic finance fits the needs of some SMEs. Rahman (2007) stresses that since SMEs are known to encourage entrepreneurship, extending assistance to SMEs could nurture further growth in the economy under the IFIs. In a study funded by the World Bank, Dhumale and Sapcanin (1999) find that certain Islamic financing schemes like *Murabahah*, *Mudarabah* and *Qardhul Hasan* are feasible to be extended as financial assistance to SMEs. *Murabahah* scheme seems to be the most suitable and appropriate financial instrument for SMEs as the buy-resell model with equal instalment is easier to administer and monitor (Suzuki & Uddin, 2016). Comparatively, *Qardhul Hasan*, *Murabahah* and *Ijarah* schemes are relatively easy to manage and will ensure the capital needs (*Qardhul Hasan*), equipment (*Murabahah*) and leased equipment (*Ijarah*) for the SMEs (World Bank-IDB, 2015). Schemes such as *Mudarabah* and *Musharakah*, on the other hand, have great potentials for SMEs financing purposes as these schemes can satisfy the risk sharing needs of the SMEs (Rahman, 2007). In theory, different schemes can be used for different purposes depending on the risk profile of the SMEs.

Ismail and Razak (2003) examine the pattern of debt-equity financing to the SMEs extended by the financial institutions (FIs) over the period of 1993 to 1997 and revealed that 95 percent of all financing were via debt financing which were *Ijarah, Bay Bithaman Ajil*, and *Murabahah.* The study concluded that SMEs prefer to choose debt financing rather than equity to set up and expand their businesses. Similar finding was also reported by Manan et al. (2011) in their survey on SMEs where a significant number of SMEs in Malaysia sought Islamic debt financing modes such as *Murabahah, Bay Bithaman Ajil* and *Ijarah* as sources of external capital.

Data and Methodology

Data for this study is taken from SME Corp. Malaysia (http://www.smeinfo.com.my). This data provides descriptive information on the characteristics of the SMEs from all the twelve states in Malaysia. SMEs, as per listing in the SME Corp. Malaysia database, are divided into two entities that are enterprises (sole proprietor and partnership) and private limited company (Sdn Bhd) as shown in Table I. The total listing of the SMEs is 60,176 entities of which 36,047 are Sdn Bhd (59.90 percent) while the remaining are enterprises i.e. 24,129 (40.10 percent). Unlike past survey studies conducted in Malaysia (see for examples; Boocock & Wahab, 2001; Manan et al., 2011; Saad & Idris, 2014), this study focuses only on Sdn Bhd (hereby termed as SMEs). This is to standardize the targeted respondents for this survey.

Table 1. SMEs sampling

State	All SMEs	Sdn Bhd	Sdn Bhd (percent)	Sdn Bhd (sample)
Johore	5477	2672	7.41	30
Kedah	1946	744	2.06	8
Kelantan	1189	260	0.72	3
Melaka	2077	664	1.84	7
Negeri Sembilan	1842	775	2.15	9
Pahang	1254	371	1.03	4
Pulau Pinang	4599	2358	6.54	26
Perak	2923	1167	3.24	13
Perlis	228	57	0.16	1
Selangor	21040	14192	39.37	157
Trengganu	1578	489	1.36	5
Wilayah Persekutuan	16023	12298	34.12	136
Total	60,176	36,047	100	400

Source: SME Corp. Malaysia (population database as at 30 November 2015)

Sample selection

Sample size plays a crucial role in obtaining stable, meaningful estimation and interpretation of results (Hair et al., 2010). The number of SMEs selected for the study is as following: Krejcie and Morgan (1970)[1] propose a specific formula to determine sample size for research activities where they provide table to determine the sample size from a given population. Following the proposed formula and table for sample selection, we determine a sample size of 400 based on 36,047 of the total population for Sdn Bhd (as at 30 November 2015). The selected sample covers all industries in the SMEs as shown in Table 2 below.

Table 2. SMEs industry classification

Industry	Frequency	Percent
Services	241	60.31
Manufacturing	75	18.69
Construction and Real Estate	68	17.00
Agriculture-related	16	4.00

To ensure correct representation of population for each state, the number of SMEs for each state is determined based on stratified sampling. Stratified sampling helps researchers to conduct different methodological techniques and procedures in different strata and it yields more accurate results than the simple random sampling (Cooper and Schindler, 2011). After determining the sample for each state, the selection of SMEs for each state is then determined according to a systematic sampling whereby every n^{th} of the identified SMEs within each state is chosen.

Questionnaire administration and data collection

This study adapts the Boocock and Wahab (2001) questionnaire with several modifications made to suit the objective of this study. The questionnaire consists of three parts with thirty questions. The first part covers demographic information (owner's education level, age, gender, race, business experience, product and industry type, firm age, firm size (total assets), ownership structure and composition of full time employees). The second part of the questionnaire elicits information related to the financing pattern of the SMEs (sources of funds, amount and tenure of debt, purpose and type of financing and financing preference). The final part of the questionnaire draws input on challenges faced by the SMEs in accessing financing. The questionnaire is accompanied by an explanatory covering letter to ensure the confidentiality of responses.

Prior to the distribution of the questionnaires, a pilot study was conducted on the drafted questionnaires to ensure readability, scaling, presentability and the arrangement of questions, the relevancy of questions and length of time taken to complete the questionnaires (Dillman, 1978). The pilot study was conducted on a small scale among ten potential SMEs around Selangor, Wilayah Persekutuan and

Putrajaya (Klang Valley). Their feedbacks were incorporated and the questionnaire was revised accordingly.

The questionnaires were distributed to each of the selected sample by hand (for SMEs located around Klang Valley) and mail. The registered address of the sample SMEs is sourced from Suruhanjaya Syarikat Malaysia (SSM). A self-addressed return envelope is also given to all respondents. Follow-up phone calls were made to ensure acceptance and response of the survey.

Data collection is conducted for five months (December 2015 – April 2016) with usable responses of 94 from the total 400 distributed questionnaires (24 percent response rate). The response rate of this study is comparable to similar studies on SMEs conducted in Malaysia (see for examples, 22 percent, 21 percent and 20 percent in Boocock & Wahab, 2001, Manan et al., 2011 and Saad & Idris, 2014, respectively). The 24 percent response rate is also considered as a highly satisfying and remarkable rate for a survey analysis in the field of finance. The usual response rate for similar surveys conducted in US and UK is 9-24% (Beattie et al. 2006).

Analysis and Findings

The collected data is analysed using the statistical software of Statistical Package for Social Science (SPSS) version 22. Descriptive analysis is conducted on the three sections of the questionnaires, namely demographic information, financing pattern and challenges.

Demographic

Most respondents (79.00 percent, N=74) are owners of the SMEs with the majority of them male (78.00 percent, N=73), then female (22.00 percent, N=21). The age of owner-managers range from 28 years to 66 years, with average age of 45.6 years. The owner-managers have a 12-year business experience on average. In terms of race, Malays constitute 86.00 percent (N=81) while Chinese 10.00 percent (N=9) and Indians 4.00 percent (N=4). As for the educational level, 48.80 percent (N=46) hold a bachelor's degree, professional certificate or diplomas, 34.68 percent (N=33) and 8.52 percent (N=8) with a master degree. The remaining 6 percent (N=6) are secondary school leavers and 2 percent (N=2) hold a PhD.

The majority of the samples are engaged in the service sector (60.31 percent, N=57), followed by the manufacturing (18.69 percent, N=18), construction and real estate (17.00 percent, N=16) and agriculture-related businesses (4.00 percent, N=4). These figures deduced from the survey conform with what has been reported in the SME Annual Report 2014/2015 where the services sector represents the largest portion, accounting for RM143.6 billion (60 percent) of total SME financing. The manufacturing sector comes second with RM41.1 billion (17.2 percent) and then the construction sector at RM27.9 billion (11.7 percent).

Looking at the age of the SMEs surveyed, apparently the age is diverse, ranging from two years in operation up to 42 years of operation with an average of 11 year. This indicates that many enterprises are still at the early stage of their lifecycles. The SMEs also seem to employ quite a significant number of employees with 32 being the average size of employment. The highest number of employees recorded in this study is 158 with 10 being the lowest. The size of employment recorded is in line with the definition of SMEs in Malaysia (full time employees not exceeding 200 and 75 for manufacturing and services sectors respectively).

Regarding the diversity of products sold by the selected SMEs, it ranges from the minimum of one product up to thirteen products, with an average of four products. These products are mainly sold to the local market, i.e., 81.80 percent while the export market constitutes 18.20 percent. In terms of assets, this study records a diverse size of assets (RM50,000 - RM200 million) with an average of RM 9 million. Details show that 32 percent have assets between RM 1 million and RM 5 million and 25 percent have assets of between RM 5 million and RM 10 million. Almost 44.0 percent have assets of less than RM 1 million and only 2 percent have assets of more than RM10 million. Table 3 summarizes the demographic of the SMEs.

Table 3. Demographic

Item		Percent
Gender	Male	78.0
	Female	22.0
Race	Malays	86.0
	Chinese	10.0
	Indian	4.0

Education	Secondary	6.0
	Bachelor	48.80
	Diploma	34.68
	Master	8.52
	PhD	2.0
Industry	Service	60.31
	Manufacturing	18.69
	Construction and Real Estate	17.0
	Agricultural	4.0
Assets	< RM 1 million	44.0
	RM1 million - RM 5 million	32.0
	> RM 5 million – RM10 million	25.0
	> RM 10 million.	2.0

The SMEs financing pattern

The following sub-sections analyse the SMEs financing that are sources of funds, amount and tenure of debt, purpose of financing and financing preference.

The study reports that SMEs source their funds mainly from personal (family savings), partners, banking institutions, development institutions, government schemes and others (such as factoring, Ar-Rahnu and pawn broking). Table 4 provides the details of sources of funding for the SMEs understudy.

Table 4. Sources of funds

Main Sources	Frequency	Percent
Personal (Family) Savings	56	59.57
Partners	6	6.38
Banking Institutions	18	19.15
Development Institutions	7	7.45
Government Schemes	4	4.26
Others	3	3.19
Total	94	100

The sources of funds are categorized as internal and external financing. Internal sources of funds comprise personal (family savings) and retained earnings, while the external sources of funds vary from individuals (partners) or financial institutions (banking, development institutions and government). Personal (family) savings constitute the biggest source of funds for the SME understudy in Malaysia (59.57 percent, N=56). This is followed by funds from banking institutions (19.15 percent, N=18), development institutions (7.45 percent, N=7), partners (6.38 percent, N=6), government schemes (4.26 percent, N=4) and others (3.19 percent, N=3). Despite being the only internal source of funds for SMEs, personal (family) savings constitute the biggest portion comparative to external sources (partners, financial institutions, government schemes and others). The external source of fund is then categorized as equity and debt financing. Funding from the development institutions (such as Perbadanan Usahawan Nasional Berhad - PUNB) constitutes three equity financing while the remaining four is debt financing. In terms of external financing itself, funding from the banking institutions constitutes the biggest portion that is, 18 out of 38 external financing (47 percent). This finding confirms the report on SME for 2014/2015 that financial institutions comprising banking institutions and development financial institutions continue to be the main provider of SME financing. Apparently, as reported in previous studies, bank financing is indeed the most preferred form of external financing sought by SMEs in other countries as well.

The following Table 5 details the amount of debt taken by the SMEs from the financial institutions (banking and development institutions). The highest amount of debt taken by the SMEs ranges from RM100,000-RM500,000 (44.83 percent, N=13) and followed by RM50,000-RM100,000 (27.59 percent, N=6). The amount of less than RM50,000 and more than RM500,000 constitute 27.59 percent (N=8) and 6.90 percent (N=2), respectively. In terms of the tenure of debt, approximately 60 percent of the SMEs rely more on short and medium term loan (less than five years) while the remaining 40 percent have access to longer term loan (more than 5 years).

Table 5. Amount of debt

Amount of Debt	Frequency	Percent
< RM50,000	8	27.59
RM50,000-RM100,000	6	20.69

RM100,000-RM500,000	13	44.83
>RM500,000	2	6.90
Total	29	100

The survey then identifies the types of debt financing engaged by the SMEs understudy, whether the conventional debt, Islamic debt financing or both. This study finds that the Islamic debt financing is preferred to the conventional debt financing, similar to the findings in Manan et al. (2011). They argue that the preference on Islamic debt financing over conventional debt is because fixed mark-up of Islamic debt would allow the borrower to have a stable payment. As shown in Table 6, 55.17 percent (N=16) of the 29 SMEs consume Islamic debt financing compared to 31.03 percent (N=9) on conventional loans. 13.79 percent (N=4) of the SMEs are found to employ both types of debts.

Table 6. Types of debt financing

Type of Debt	Frequency	Percent
Islamic	16	55.17
Conventional	9	31.03
Both	4	13.79
Total	29	100

The SMEs which subscribe to the Islamic debt financing were asked further on the modes of financing that they had chosen to finance their operation. As reported in Table 7, *Murabahah* is found to be the most preferred mode of Islamic debt financing (31.25 percent, N=5), followed by *Bay Bithaman Ajil* and *Qardhul Hasan* (each amounting to 18.75 percent, N= 3). Other modes of financing such as *Ijarah*, *Bay al-Dayn*, *Bay al-Inah/Tawarruq* and others (*Kafalah* and *Wakalah*) constitute the remaining portions. The preference on *Murabahah* confirms the argument made by Suzuki and Uddin (2016) and World Bank-IDB (2015) that the *Murabahah* scheme seems to be the most suitable and appropriate financial instrument for the SMEs as the buy-resell model with equal instalment is easier administered by both borrowers and lenders. World Bank-IDB (2015) also reports that product offerings for SMEs from Islamic banks (except in some countries such as Indonesia or Pakistan) are significantly limited to debt-based financing such as *Murabahah.* The findings from this study also reflect the percentage of types of Islamic financing in the Islamic banking system (end of

June 2016) in which *Murabahah* constitutes the highest portion i.e. 34.4 percent, followed by *Bay Bithaman Ajil* and *Ijarah*, 17.5 percent and 17.0 percent respectively (Monthly Statistical Bulletin, BNM). Manan et al. (2011) suggest that the high preference on *Murabahah*, *Bay Bithaman Ajil* and *Qardhul Hasan* is probably because the three financing modes suit the needs of financing as an on-going business such as trade financing, working capital financing and business financing.

Table 7. Modes of Islamic debt financing

Modes	Frequency	Percent
Murabahah	5	31.25
Bay Bithaman Ajil	3	18.75
Bay al-Inah/Tawarruq	1	6.25
Qardhul Hasan	3	18.75
Ijarah	2	12.5
Bay al-Dayn	1	6.25
Others	1	6.25
Total	16	100

This study also investigates the purpose of seeking financing among the SMEs with both optional and open-ended questions. As shown in Table 8, working capital is listed as the main reason for seeking financing (34.04 percent, N=32), which is in line with what has been reported in the annual report on SMEs for 2014/2015. The report states that the majority of the SMEs need financing for the purpose of purchasing raw material (working capital) as well as machinery and equipment. The purpose of seeking financing is then followed by the purchase/lease of equipment, machinery and vehicles (24.47 percent, N=23), acquiring of land and building (12.77 percent, N=12) and upgrading of the production process (11.70 percent, N=11). Other purposes of financing include project financing (9.57 percent, N=9), product development (3.19 percent, N=3) and others (4.26 percent, N=4).

Table 8. Purpose of financing

Purpose of Financing	Frequency	Percent
Working Capital	32	34.04
Purchase/lease of equipment/machinery/vehicles	23	24.47
Land/building	12	12.77
Improvement/upgrade of production process	11	11.70

Product Development	3	3.19
Project Financing	9	9.57
Others	4	4.26
Total	16	100

Challenges Faced by SMEs in Securing Financing

The SMEs were also asked on constraints facing them in securing financing for their businesses. Lack of collateral is ranked as the main obstacle facing them (57.30 percent, N=54). As shown in Table 9, most of the fund providers request collateral as a form a guarantee on financing. This is followed by insufficient loan documentation (18.20 percent, N=17) and lack of financial track record (10.28 percent, N=10). Other challenges include long loan processing time (7.60 percent, N=7), viability of business plan (4.32 percent, N=4) and other factors (2.30 percent, N=2).

Table 9. Challenges in securing financing

Challenges	Frequency	Percent
Lack of collateral	54	57.30
Insufficient documents to support loan application	17	18.20
No financial track record	10	10.28
FIs deem business plan as not viable	4	4.32
Long loan processing time	7	7.60
Others	2	2.30
Total	94	100

Apparently, one main challenge that hinders the SMEs understudy in securing financing from financial institutions is the lack of collateral as shown in Table 9. This reinforces what has been documented in the literature that financial institutions will insist on loans to be backed by collateral or other third party guarantee. Ramlee and Berma (2013) highlight that SMEs with no documentations on trading history and with no accumulated assets to back loan application are seen to be the most risky borrowers; thus lenders are very reluctant to lend. Duasa et al. (2014) report that financial institutions are charging higher interest rates on MEs in order to compensate for higher costs of information collection and greater risk of failures. In Malaysia, the imposition of single borrowing limit based on the debt ratio of the SMEs has led to a very limited amount of loan exposures to the SMEs as borrowers. Loans are normally approved based on the amount of internal savings or other internal funds injected in the SMEs. Being an SME, limited internal financial sources and the lack of evidence or documentation to support the financial application usually elongates negotiation process or even rejection.

Conclusion

This study investigates the access to financing problems of SMEs in Malaysia as the engine of growth for the economy so as to understand further their nature and needs to ensure sustainability and prosperity. The financing needs of the SMEs differ according to the different phases of their operation. The nature of SMEs, especially at their initial stage of operation such as informational opacity, limited documentation on trading history and the lack of collateral have hindered them from securing external financial assistance from financial institutions.

From the survey conducted, this study found that similar to past studies, personal saving or internal funding constitutes the biggest portion of financial sources for the SMEs compared to external funding. Second comes funding from the banking institutions, the biggest outside funder revealed from this study, government schemes and other development institutions. More than half of the SMEs understudy rely on short and medium term loan since it is difficult to secure long term loan for an SME. Lack of collateral is ranked as the main obstacle since financial institutions will insist that loans are backed by collateral or other third party guarantee.

From the view of Islamic social financing, looking at the feasibility of Islamic financing schemes to be extended to the SMEs, this study found that generally, the Islamic debt financing is preferred to the conventional debt financing. This may be because that fixed mark-up of Islamic debt would allow the borrower to have a stable payment. *Murabahah, Bay Bithaman Ajil* and *Qardul Hasan* are found to be the most preferred modes of Islamic debt financing by SMEs. Other modes of financing such as *Ijarah*, *Bay al-Dayn*, *Bay al-Inah/Tawarruq* and others (*Kafalah* and *Wakalah*) come next in the list. These Islamic financing instruments are preferred by the SMEs as they are relatively easy to manage and will ensure the capital needs and can satisfy the risk sharing needs of the SMEs. Theoretically, different schemes can be used for different purposes depending on the risk profile of the SMEs.

Hence, various Islamic financing schemes based on the concepts of *Mudarabah*, *Musharakah*, *Murabahah*, *Ijarah* and so forth have the salient features and characteristics to assume the Islamic social financing responsibilities that can contribute towards a more ethical economic and financial development of the SMEs. Islamic finance bears crucial responsibility in furthering socio-economic development of the SMEs without charging interest or *riba* with moral and ethical attributes that can effectively motivate SMEs to flourish in a more conducive financing environment in realizing the *Maqasid al-Shari'ah.*

End Note

[1] Krejcie and Morgan (1970) propose the following formula to determine sample size for research activities. $s = X^2 NP(1-P) \div d^2 (N-1) + X^2 P(1-P)$, where s = the required sample size, X^2 = the table value of chi-square for 1 degree of freedom at the desired confidence level (3.841), N = the population size, P = the population proportion (assumed to be 0.50 since this would provide the maximum sample size), d = the degree of accuracy expressed as a proportion (0.05). Krejcie and Morgan in their article dated 1970, provide table for determining sample size from a given population.

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