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UNVEILING FACTORS IN NON-PERFORMING LOANS: EXPLORING THE RURAL ECONOMIC FINANCING SCHEME

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Abstract

The Rural Economic Financing Scheme (SPED) programme, initiated by the Ministry of Rural and Regional Development (KKDW), aims to enhance rural areas' development, and uplift the socio-economic status of rural communities. Despite being implemented for two decades since 2001, no comprehensive studies have examined the impact of SPED on entrepreneurs, particularly regarding the implications of financing on their businesses. This study focuses on the issue of Non-Performing Loans (NPL) among SPED borrowers, aiming to identify the contributing factors to NPL problems. To achieve the study's objective, a mixed-methods research design was employed, incorporating quantitative and qualitative approaches. The findings indicate that entrepreneurs experiencing NPL issues often face challenges stemming from their limited knowledge, skills, and inadequate financial management capabilities, such as insufficient understanding of loan terms, ineffective financial planning, and suboptimal debt management. This study's outcomes contribute to a better understanding of the implications of SPED financing on entrepreneurs in rural areas and shed light on the factors influencing NPL among SPED borrowers, suggesting the need for targeted interventions and support mechanisms, such as training programs and mentorship opportunities, to enhance the financial management skills of SPED borrowers and mitigate NPL risks.

Keywords: Rural Development, Non-Performing Loan, Rural Entrepreneur, Bumiputras, Financial Management.

1. INTRODUCTION

The Rural Economic Financing Scheme (SPED) was introduced in January 2001 as part of the Ministry of Rural Development's (KKDW) initiatives to stimulate business and entrepreneurship among rural Bumiputras. This scheme offers unsecured loans with favorable repayment rates, specifically tailored to support rural Bumiputera entrepreneurs. The scope of SPED financing encompasses various business needs, such as asset acquisition, machinery, and

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equipment purchase, working capital for raw materials and inventory procurement, as well as renovation or upgrading of business premises. The financing package comprises a combination of a 70% loan and a 30% grant, with a maximum funding limit of RM250,000. The scheme strictly adheres to Shariah principles and operates through collaboration between Bank Kerjasama Rakyat Malaysia (BKRM) and Small Medium Enterprise Development Bank (SME Bank).

The primary objective of SPED is to provide viable financing opportunities to rural Bumiputras entrepreneurs across different sectors of the economy that comply with legal and Shariah requirements. By facilitating access to funding, SPED aims to foster the growth of businesses, job creation, and income generation, thereby improving the living standards of rural communities. Eligible sectors for SPED financing include services, manufacturing, agriculture, and rural tourism. The financing ranges from a minimum of RM20,000 to a maximum of RM250,000 per application, with a loan tenure of 3 to 7 years. The financing structure involves a 30% government grant rebate based on the approved principal financing amount, while the remaining 70% constitutes the loan with an interest rate or profit margin of 5%. From 2001 to 2020, a total of 4,006 individuals received loans through SPED, amounting to a budget of RM406,946,720.71. The average loan size provided was approximately RM100,000, and the scheme attracted participation from 2,360 male entrepreneurs and 1,646 female entrepreneurs nationwide.

Despite SPED's two-decade implementation, there is a dearth of comprehensive studies examining the factors contributing to Non-Performing Loans (NPL) among entrepreneurs who have availed themselves of this financing scheme. Consequently, there is a critical need to investigate the entrepreneur selection process and enhance the financing procedures to improve the success rate of rural entrepreneurs. This study seeks to address this gap by reviewing the factors impacting NPL and proposing improvements in the financial management system for rural Bumiputra entrepreneurs as SPED borrowers. Through these efforts, it aims to contribute to the overall development and prosperity of rural communities, while supporting the sustainability of high-potential economic sectors.

2. LITERATURE REVIEW

The classification of Non-Performing Loans (NPL) pertains to loans where the principal or interest payments remain outstanding for a specified period, typically three months or more. NPLs can have significant implications for banks' financial stability (Bank Negara Malaysia, 2021). In the context of this study, NPL refers to SPED borrowers' failure to make payments for three months, either for principal or loan interest.

Previous research has highlighted the impact of macroeconomic factors on NPL. For instance, (Louzis et al., 2012) found that factors such as GDP growth rate, unemployment rate, borrowing rate, and public debt significantly influence NPL. Similarly, (Berge & Boye, 2007) highlighted the actual interest rate and unemployment as crucial factors contributing to NPL challenges, particularly within the Norwegian banking system.

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NPLs pose a threat to banks' financial stability and are demonstrated to cause detrimental effects on banking institutions (Noreni Mohamad Zain et al., 2020). Addressing this issue requires entrepreneurs to acquire knowledge of business and financial management. However, studies indicate that entrepreneurs have limited knowledge of financial management (Rachapaettayakom et al., 2020) and this lack of knowledge impacts debt management and overall financial well-being (Arrondel, 2021); (Ahsan, 2013). Factors such as the business environment and access to capital also influence financial management levels (Chen, 1998); (Danes & Haberman, 2007); (Manton et al., 2006); (Peng et al., 2007);(Voipe et al., 1996), while gender has been found to have no significant influence (Ibrahim et al., 2009).

However, limited knowledge of financial management is not the sole determinant of NPLs. The thinking style and behavior of entrepreneurs also play a crucial role (Khan et al., 2020). Changing behavior presents a significant challenge even though enhancing knowledge, skills, and attitudes is feasible. Entrepreneurial education and knowledge are vital in mitigating NPL occurrences. (Robertson & Collins, 2003) found that entrepreneurial education raises awareness and emphasizes the importance of entrepreneurship, leading to attitude and skill transformations. Additionally, educational background is recognized as an influential variable for community engagement in entrepreneurship (Marques et al., 2018).

3. METHODOLOGY

This research study employs a combination of quantitative and qualitative research methods. The quantitative approach involves the collection of data using questionnaires and bank reports. On the other hand, the qualitative approach involves conducting field study observations and interviews with key stakeholders, including financiers (KKDW), financier managers (banks), and entrepreneurs who participated in the SPED program.

The study focuses on a population of 517 entrepreneurs who have received funding through the SPED program. From this population, a sample of 347 SPED participants, specifically those who received funding between 2014 and 2018, were selected for the study. The minimum required sample size of 218 individuals was determined using the (Krejcie & Morgan, 1970) suggested table. The sampling process encompassed various regions across the country, ensuring representation from diverse geographical areas. The data collection phase lasted for 32 weeks, spanning from mid-September 2020 to the end of April 2021.

The interviews conducted with the participants generated valuable insights, which were transcribed verbatim and analyzed using NVivo software. This analysis aimed to identify recurring themes and categorize responses into meaningful groups. Additionally, the quantitative data collected were subjected to descriptive analysis using SPSS software. This analysis facilitated the presentation and interpretation of the obtained data in a structured manner.

By employing a combination of quantitative and qualitative methodologies, this study seeks to provide a comprehensive understanding of the factors influencing the Non-Performing Loans (NPL) issue among entrepreneurs who received financing through the SPED program. The

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findings from this research will contribute to enhancing knowledge in this field and inform potential improvements in the financial management system for rural Bumiputra entrepreneurs as SPED borrowers.

4. RESEARCH FINDINGS

The study focused on borrowers from 2014 to 2018, utilizing three sources of data: bank documents, interviews with top management and bank staff, and SPED participants.

Table 4.1: Non-Performing Loan Status Table (NPL) by Business Type and Gender

Business Type	Gender	Total	Status OK	Percentage OK	Status NPL	Percentage NPL
Services	Male	162	96	59.30%	66	40.70%
	Female	133	88	66.20%	45	33.80%
	Total	295	184	62.40%	111	37.60%
Manufacture	Male	22	16	72.70%	6	27.30%
	Female	22	11	50.00%	11	50.00%
	Total	44	27	61.40%	17	38.60%
Agriculture	Male	7	2	28.60%	5	71.40%
	Female	3	3	100%	0	-
	Total	10	5	50.00%	5	50.00%
Total		349	216	61.90%	133	38.10%

Table 4.1 presents the NPL status categorized by business type and gender of the entrepreneurs. In the service sector, male entrepreneurs exhibited an OK status of 59.3%, while female entrepreneurs showed a higher rate of 66.2%. These percentages indicate that most loans for service-based businesses were in good standing. Conversely, the NPL status for service businesses was relatively low at 37.6%. In the manufacturing sector, male entrepreneurs demonstrated a higher OK status at 72.7%, whereas female entrepreneurs had a rate of 50%. Regarding NPL status, male entrepreneurs had a significantly lower rate of 27.3%, whereas female entrepreneurs showed a higher rate of 50%. In the agricultural sector, female entrepreneurs had a 100% OK status, while male entrepreneurs had a significantly higher NPL rate of 71.4%.

Within the manufacturing sector, the NPL rate was higher among female entrepreneurs compared to male entrepreneurs, suggesting that female entrepreneurs exhibited less discipline in loan repayments. In the agricultural sector, the NPL rate among male entrepreneurs was the highest at 71.4%, while female entrepreneurs demonstrated a 0% NPL rate. This discrepancy can be attributed to environmental factors.

Overall, the NPL status for both genders indicated a relatively low rate of 37.1%, with a corresponding OK status of 61.9%. These findings highlight the need to further investigate the factors contributing to the NPL status among SPED borrowers. Identifying the underlying causes and addressing them can lead to improved financial management and a reduction in NPLs, ultimately promoting the success and sustainability of rural Bumiputra entrepreneurs participating in the SPED program. Further analysis and exploration of these findings will

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provide valuable insights for policymakers, financial institutions, and entrepreneurs aiming to enhance the effectiveness of financing programs and foster economic development in rural areas.

Table 4.2: Percentage of Loan Status by Business Type (Good)

Status	Types of business	1k-50K	51K-100K	101K-150K	151K-200K	More 200K	Total	Percentage
	Services	61	59	22	19	23	184	85.20%
Good	Manufacture	6	11	4	1	5	27	12.50%
	Agriculture	1	4	0	0	0	5	2.30%
Total		68	74	26	20	23	216	100%

Table 4.3: Percentage of Loan Status by Business Type (NPL)

Status	Types of business	1k-50K	51K-100K	101K-150K	151K-200K	More 200K	Total	Percentage
	Services	24	46	18	11	12	111	90.20%
NPL	Manufacture	4	5	2	2	4	7	5.70%
	Agriculture	2	1	2	0	0	5	4.10%
Total		30	52	22	13	16	123	100%

Table 4.2 and Table 4.3 present the distribution of loans based on the business type and the status of entrepreneurs. In terms of good status, 85.2% of entrepreneurs obtained financial loans for service businesses, while 12.5% and 2.3% secured loans for manufacturing and agricultural businesses, respectively. Breaking down the percentages, 68 entrepreneurs received loans ranging from RM1,000 to RM50,000 for service businesses, 74 entrepreneurs obtained loans ranging from RM51,000 to RM100,000, 26 entrepreneurs secured loans ranging from RM101,000 to RM150,000, 20 entrepreneurs availed loans ranging from RM151,000 to RM200,000, and 23 entrepreneurs acquired loans exceeding RM200,000.

On the other hand, the NPL status revealed that 90.2% of loans for service businesses turned into non-performing loans, while the percentages for manufacturing and agricultural businesses were 5.7% and 4.1%, respectively. The high NPL rate among service business loans indicates a concerning trend that adversely affects lending banks or agencies. This situation poses challenges in terms of capital return and overall financial sustainability.

The findings from these tables shed light on the significant proportion of entrepreneurs experiencing difficulties in meeting loan repayment obligations, particularly in the service business sector. This research highlights the pressing need to address the underlying factors contributing to high NPL rates to safeguard the financial health of both entrepreneurs and lending institutions. Implementing effective financial management strategies, providing targeted support and education for entrepreneurs, and establishing risk assessment measures can potentially mitigate the occurrence of non-performing loans and promote sustainable entrepreneurship in rural communities. Further investigation and analysis of these findings will contribute to the body of knowledge in the field and facilitate evidence-based decision-making for policymakers and financial stakeholders.

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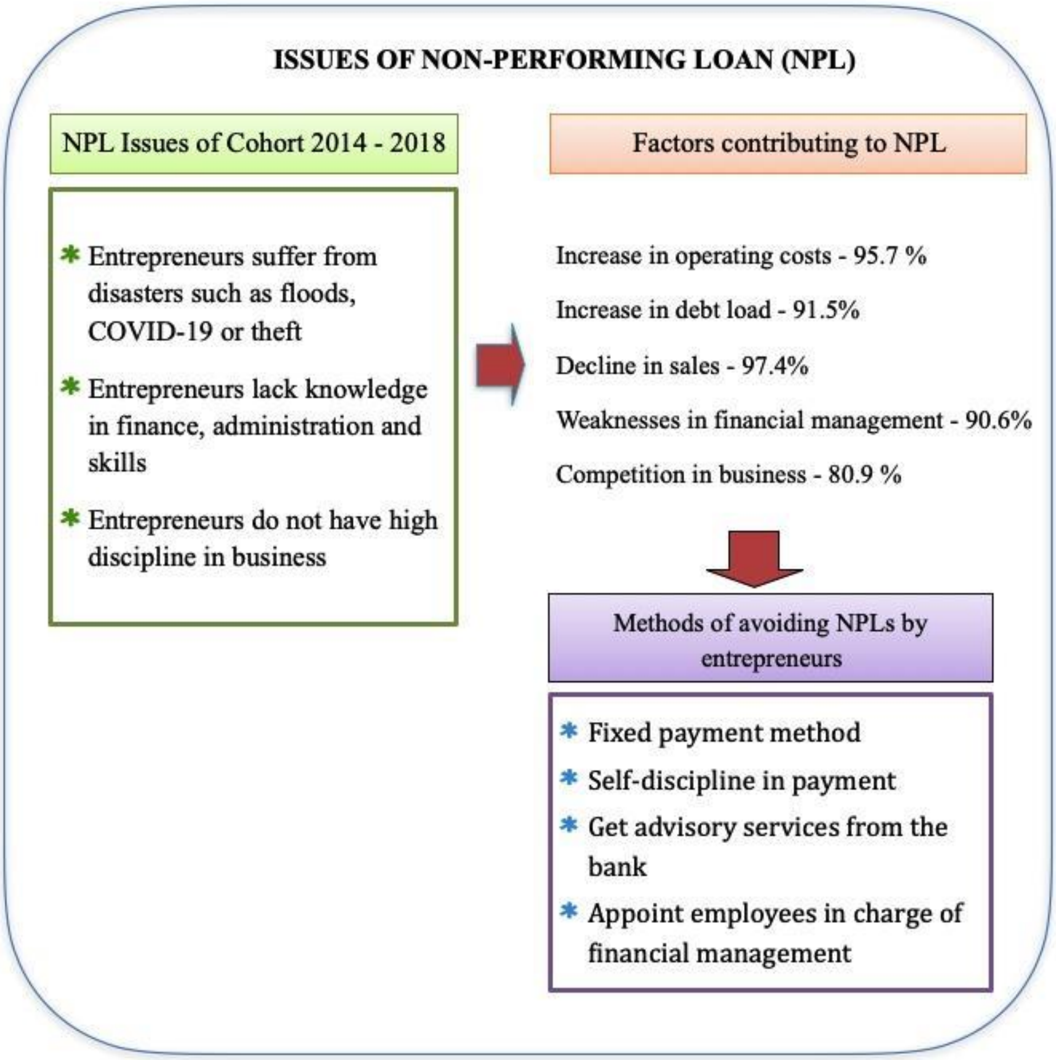

Figure 1: Issue of Non-Performing

The research findings presented in Figure 1 highlight the contributing factors to non-performing loans (NPL) as well as the strategies employed by entrepreneurs to avoid such situations.

Identified factors that contribute to NPL cases include problematic business ventures, where entrepreneurs struggle to maintain profitability and generate sufficient income to meet loan obligations. Another significant factor is the misuse of loan funds for personal purposes unrelated to the intended projects. External circumstances such as natural disasters, theft, and the adverse impact of the COVID-19 pandemic further compound the challenges faced by entrepreneurs in loan repayment.

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Entrepreneurs have adopted various strategies to mitigate the risk of NPL. One effective approach is the implementation of disciplined payment systems, such as utilizing fixed fee payments like post-dated cheques. This method ensures timely repayments and minimizes the risk of default. Seeking guidance and advice from banks has also proven beneficial, allowing entrepreneurs to tap into valuable financial expertise and enhance their financial management practices. Additionally, appointing dedicated employees to oversee financial matters enhances accountability and ensures the proper allocation of loan funds.

The findings underscore the importance of comprehensive financial education and support programs to equip entrepreneurs with the necessary skills for effective financial management. By enhancing their understanding of financial principles, entrepreneurs can make informed decisions and avoid the pitfalls that lead to NPL cases. Policymakers and relevant stakeholders are encouraged to develop targeted initiatives that provide ongoing guidance, monitoring, and assistance to entrepreneurs in rural areas, enabling them to establish successful and sustainable businesses.

Financial institutions play a crucial role in preventing NPL cases by offering advisory services and implementing monitoring mechanisms. Active engagement between entrepreneurs and banks helps navigate financial challenges, identify potential risks, and develop strategies to mitigate them. Establishing collaborative relationships between entrepreneurs and financial institutions contributes to a healthier lending ecosystem and reduces the incidence of NPL.

Overall, the findings emphasize the significance of proactive measures in addressing NPL issues. By addressing contributing factors, promoting financial education, and facilitating support networks, policymakers, financial institutions, and entrepreneurs can collectively work towards creating an environment conducive to rural business development while minimizing NPL risk and ensuring loan repayment sustainability.

The interviews conducted with entrepreneurs shed light on the primary reasons for NPL, including problematic business ventures and the misuse of loans for personal purposes. Internal factors such as the lack of self-discipline and weaknesses in financial management, administration, and skills were also identified. Enhancing entrepreneurs' financial management knowledge and skills is crucial to mitigate financial burden issues that deviate from their original financial plans.

SPED participants have adopted several methods to prevent NPL cases. These include fixed fee payments, self-discipline in installments, seeking advice from banks, and appointing individuals responsible for financial matters. The study suggests that conducting comprehensive background checks on prospective SPED participants would ensure their suitability for the program. Successful entrepreneurs are advised to establish their advantages and strategies before seeking loans, emphasizing the importance of business discipline to adhere to predetermined schedules. Implementing effective monitoring systems, both by borrowers and banks, plays a critical role in ensuring loans contribute to business growth. Additionally, bankers offering advisory services in financial management indirectly help prevent NPLs by improving financial practices.

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The findings highlight the need for comprehensive financial education and support programs to enhance entrepreneurs' financial management skills and minimize NPL occurrences. The study recommends active engagement from the government and relevant stakeholders to provide ongoing guidance, monitoring, and continuous assistance, fostering responsible loan utilization and contributing to the long-term sustainability of rural business development.

5. CONCLUSION/ RECOMMENDATIONS

5.1 Conclusion

In conclusion, this research sheds light on the factors contributing to non-performing loans (NPL) among entrepreneurs and highlights strategies employed to mitigate the risk of NPL. The findings reveal that problematic business ventures, misuse of loan funds, external circumstances, and internal factors such as financial management weaknesses contribute to the occurrence of NPL. However, entrepreneurs have implemented various methods to avoid NPL, including disciplined payment systems, seeking guidance from banks, and appointing dedicated employees to handle financial matters.

The study emphasizes the importance of comprehensive financial education and support programs to enhance entrepreneurs' financial management skills. By equipping entrepreneurs with the necessary knowledge, they can make informed decisions and effectively manage their finances, reducing the likelihood of NPL cases. Additionally, the findings emphasize the crucial role of financial institutions in providing advisory services and monitoring mechanisms to prevent NPL occurrences.

5.2 Recommendations

Based on the research findings, several recommendations can be made to address the challenges associated with NPL among entrepreneurs:

Strengthen Financial Education Programs: The government and relevant stakeholders should develop and enhance financial education programs targeted specifically at entrepreneurs. These programs should provide comprehensive training on financial management, budgeting, cash flow management, and loan utilization to equip entrepreneurs with the necessary skills and knowledge.

Promote Collaboration between Entrepreneurs and Financial Institutions: Financial institutions should establish collaborative relationships with entrepreneurs, offering guidance, monitoring, and advisory services. This collaboration can help entrepreneurs navigate financial challenges, identify potential risks, and develop strategies to avoid NPL.

Improve Loan Screening and Selection Processes: The Ministry and lending institutions should conduct more comprehensive background checks and due diligence to ensure the suitability of prospective loan recipients. This will help assess their business viability, financial discipline, and capacity to repay loans, reducing the risk of NPL.

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Provide Ongoing Support and Assistance: The government, financial institutions, and relevant agencies should offer continuous support to entrepreneurs through mentoring programs, business advisory services, and networking opportunities. This support will enable entrepreneurs to access guidance and expertise, enhancing their financial management capabilities.

Foster Collaboration and Knowledge Exchange: Initiatives should be undertaken to encourage collaboration and knowledge exchange among entrepreneurs. Creating platforms where entrepreneurs can share their experiences, challenges, and best practices will help them learn from one another and adopt effective strategies to avoid NPL.

5.3 Limitations:

It is important to acknowledge the limitations of this research:

Sample Size and Generalizability: The study focused on a specific population of 517 entrepreneurs who participated in the SPED program from 2014 to 2018. While efforts were made to select a representative sample, the findings may not be generalizable to all entrepreneurs or different geographical regions. Further research with a larger and more diverse sample is recommended to enhance the generalizability of the findings.

Reliance on Self-Reported Data: The study relied on self-reported data through questionnaires and interviews, which may be subject to recall bias or social desirability bias. Future studies could incorporate objective measures and data sources to provide a more comprehensive analysis.

Time Constraint: The data collection process took place over 32 weeks, which may have limited the depth of analysis and understanding of long-term trends. Longitudinal studies spanning multiple years could provide a more comprehensive understanding of the factors contributing to NPL and the effectiveness of avoidance strategies.

Despite these limitations, this research contributes valuable insights into the factors influencing NPL among entrepreneurs and offers practical recommendations to mitigate the risk. It serves as a foundation for further exploration and provides a basis for policymakers, financial institutions, and entrepreneurs to develop targeted interventions that support responsible loan utilization and sustainable business growth.

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