

## **The Study on Factor That May Influence Credit Risk Management Knowledge and Awareness among Micro Business in Malaysia**

<sup>1</sup>Mohamad Yazis Ali Basah, <sup>1</sup>Nur Masitah Muhamad, <sup>1</sup>Hisham Sabri, <sup>1</sup>Khairil Faizal Khairi, <sup>1</sup>Mahdhir Abdullah and <sup>2</sup>Mazlynda Md Yusuf

<sup>1</sup>Faculty of Economis and Muamalat, Universiti Sains Islam Malaysia, 71800 Bandar Baru Nilai Negeri Sembilan, Malaysia

<sup>2</sup>Faculty of Science and Technology, Universiti Sains Islam Malaysia, 71800 Bandar Baru Nilai, Negeri Sembilan, Malaysia

---

**Abstract:** Micro business plays an essential role for the development of Malaysia. Based on SME annual report year 2011, micro business represents almost 80% of business census. This figure showed the importance of micro business towards the development of country. However, there are many problems associates with micro business such as difficulties to get financing, shortage of capital, owners' knowledge and experience and others. There are many study conducted on how microbusiness get financing, knowledge of accounting, entrepreneurial behaviour but there is limited study on how credit risk management in microbusiness. Additionally, the main critiques in micro business also about entrepreneurs' knowledge in term of credit risk management in running the business. This knowledge is very important in order to have a good business performance and sustainability. For that reason the study is conducted in order to explore on how credit risk management knowledge and awareness among the entrepreneurs can be associated with different types of business-sole-proprietorship, partnership and private limited company. The study is conducted by distributing 460 questionnaires among micro business in Negeri Sembilan. The results shows mixed significant results on the relationship between types of business with credit risk awareness and credit risk knowledge. There is a significant difference among types of business on credit risk awareness; however there is no difference for different types of business with knowledge of credit risk management. The findings are very important for the better development and management of microbusiness in Malaysia. It is very useful for financial provider, government and entrepreneur.

**Key words:** Credit risk management, credit management, microbusiness, Negeri Sembilan, awareness

---

### **INTRODUCTION**

Generally, the definition of micro business is defined by considering at the number of workers or its annual revenue. Apart from that, the term of micro business as accorded by Economic Census 2011 can be defined as the business that comprise of annual revenue <RM250,000.00 for manufacturing sector, RM200,000.00 for other sector and comprises of <5 permanent full time workers for all sector. According to SME Corp, micro business is one of the categories in the SMEs and the other categories are medium sized companies and small business activities.

Due to lack of specific information on micro business, this study will present information on SMEs, since micro business as one of the biggest share proportion in SMEs. According to SME Annual Report 2011/2012, 77% of the

SMEs were micro business. It shows that micro business is a biggest proportion in SMEs. Basically, the existence of small and medium business is begins from micro business. Therefore, it is important to combat the problem in micro business as a beginning stage of business growth. There are many problems associates with micro business such as difficulties to get financing, shortage of capital, owners' knowledge and experience and others.

There are many study conducted on how microbusiness get financing, knowledge of accounting, entrepreneurial behavior but there is limited study on how credit risk management in microbusiness. Additionally, the main critiques in micro business also about entrepreneurs' knowledge in term of credit risk management in running the business. This knowledge is very important in order to have a good business performance and sustainability. For that reason the study

is conducted in order to explore on how credit risk management knowledge and awareness among the entrepreneurs can be associated with different types of business-sole-proprietorship, partnership and private limited company.

**Literature review:**

**The concept of credit risk:** Credit involves the activities of lending. It has a meaning to finance either directly or indirectly the expenditures of others against future repayment. Direct credit is a credit provided by financial institutions to a customer. While indirect credit is a credit facilities granted by a trader to a customer. In business, credit risk may happen in two circumstances. First, risk as a borrower and second, risk as a lender.

According to Douglas, credit risk is the risk that a debt instruments will decline in values as a result the borrower’s inability to satisfy the contractual terms of its borrowing arrangement. In financial institutions, credit risk occurs resulting from inability to collect anticipated interest earning as well as the loss of principle resulting from loan default.

**The factors of credit risk:** Among of the causes of credit risk are lack of knowledge and awareness towards loan commitment. Knowledge can be defined as facts, information and skills acquired by a person through experience or education. Knowledge in this study refers to knowledge towards credit risk management. Knowledge becomes an essential element in managing credit risk. According to Marshall, they claimed that the failure of risk management as a result of lack of knowledge. To extant this further, Table 1 shows the personal engaged in micro business by education qualification that represent the knowledge of Malaysian entrepreneur engaging in business. Table indicates that majority of the micro business under the category of secondary and below level of education. Whereas, financial system is very complex that consists of difficult procedure to understand. In fact, there are could be some problem associated with the micro business in managing credit facilities efficiently.

Besides that, awareness can be defined as concern about and well-informed interest in a particulars situation or development. Awareness also may lead to someone’s attitude. Result to some action. In the situation of someone who running the business with lack of awareness on credit risk management may result to unethical on utilization of loan. This further causes of credit risk in business. Micro entrepreneur should be able to differentiate between business needs and personal needs. They should aware to put aside their personal

**Table 1: Personal engaged in micro business by educational qualification**

| Sector        | Category   |             |                         |
|---------------|------------|-------------|-------------------------|
|               | Degree (%) | Diploma (%) | Secondary and below (%) |
| Manufacturing | 4.10       | 10.20       | 85.70                   |
| Service       | 7.60       | 20.30       | 72.10                   |
| Agricultural  | 1.10       | 4.10        | 94.70                   |

Aris

interest. Any credit commitment given need to be settled down by the borrower as stipulated agreement and use the money for business purpose accordingly. According to Norell (2001) when the borrower received more loans, there is a tendency that the excess loan may be diverted to other unproductive, none for business purpose. Hence, the awareness of unethical on utilization of loan among micro entrepreneur becomes causes of credit risk happen.

Based on the factors discuss above, it is important to investigate on the factor that may influence credit risk management knowledge and awareness among micro business. The factors will be examined in this study is types of business. This is due to types of business may influence nature of business operation and its performance.

**Issues of credit risk management:** The issue of credit risk management may affect business performance. Numerous countries such as United States of America, Australia and United Kingdom as well as Malaysia have been studied of the reasons of business failure. However, the real cause of failure in every country might be different each other depending on environment, types of business and the year of the business failure. Larson and Clute found that 40% of business fails was due to deals with the issue of accounting and finance. In addition, 39% of business was fails due to financial difficulties that unable to manage inventory, 26% of a business did not have financial report and 22% did not have complete financial report.

On top of that, Peacock study on the factors of bankruptcy among 132 firms in 1986 and founded that the main factors of business failure was the absence of financial report. William revealed that there is positive relationship on business failure with preparation of uncompleted financial report. Besides that, the frequent of keeping financial reports have a positive relationship with the success of a business.

O’Neill and Jacob Ducker revealed that debt liability is one of the main reasons for business failure. Besides that, they found that most of the businesses failure has a high level of debt. In addition, the study conducted by Khan and Rocha revealed that most of the business failure did not used systematic accounting procedure and most of them prepared financial report was only for tax

calculation alone. Besides that, Khan and Rocha also found that most of the business was faced with the problem of working capital management.

A study at Canada indicated that most of the business failure was due to absence of financial report that cause there was no confident by most of the banks towards the business. Besides that, business failure also faced with a higher total bad debt due to lack of credit risk management. Bruno and Leidecker found that financial problem was factor of business failure such as start the business with lack of capital.

Based on the explanation above, numerous evidences from previous studies showed that financial reporting and working capital management play an essential role in sustaining the successfulness of business especially in managing credit risk. A business is unable to manage working capital as well as credit risk if they lack of knowledge and awareness in credit risk management.

**Empirical study on credit risk management:** Micro business is one of the important contributions towards the development of nation. Therefore, the longevity of micro business should be given special attention from many parties as well as in the aspect of business activities especially in managing credit risk. This section is aims to present the empirical study on credit risk management. Many of the study conducted on probability of default among micro business towards its repayment obligations. Among of the researchers that conduct the study on the probability of payment default are Roslan and Karim (2009), Chong (2010), Ivicic and Cerovac (2009). According to Roslan and Karim (2009) the probability of default for loan repayment was influenced by gender of the borrower, types of business, amount of loan and the period of loan. While other researcher studies on the strategy to manage credit risk in the business level as well as in the banking sectors to prevent the probability of payment default. In their study, the banking sector in Uganda was used fixed monthly repayment schedule for customer to repay their loans.

While one study in Ghana reveals that the micro-credit institutions had higher default rate, operating far below the Bank of Ghana. In addition, the study suggest that the bank should adopt innovating lending methodologies such as group lending and dynamic lending to joint liable-liable group. Managing and analysing risk is a vital process for all business in over the world. Alina (2009) conducted the study on credit analysis claimed that the evaluation of company's

financial statements and the ratios that indicate the efficiency of the company's performance will thus provide an indicator of probability of success of the ability to service its debt in the future. Indirectly, it's indicates that financial statements is important in order to evaluate company's performance. Besides that, Micro finance institutions will offer micro credit facilities for any thriving business. Basically, they would request for the financial report before approve loan application from the applicant.

Monitor and measure the risk within a micro business loan portfolio is important. Risk rating system is used to monitor and measure risk in the business. In the case of credit risk, credit rating system can be used to measure and monitor credit risk in a business. There are many researchers conduct the study on the risk rating system and credit rating system. Recently, there are many credit risks modelling have been introduced by JP Morgan with credit merits, KMV, Credit Suisse Financial Products (CSFP) and McKinsey and company which provides alternative modelling choices. Credit provider should determine what kind of model they would use. There are many study conducted on the credit risk modelling to study regarding the challenges, consequences and calculation of probability of loss distribution in credit portfolio. Among of the researches that study on this particular area are Giesecke (2004). There are four modelling that widely used by industry to value credit risk which are credit migration approach, structural approach, credit risk<sup>+</sup> and credit portfolio view.

All the studies above showed that micro credit facility gives a positive impact to the micro business. But, a study conduct by Paul Swider reveals that however 13 million micro entrepreneurs worldwide have benefited from micro credit but there remain 200 million families who have work hard but cannot access affordable credit. Some of the entrepreneur do not access for the credit facilities is due to lack of knowledge on the facilities provided.

Managing working capital effectively will result in better profitability for any business. This is due to various study was reveals that profitability of a firm was depend upon a management of working capital. There are many study conducted to show the important of management of working capital which are Agyemang and Kwame (2013), Rahman (2011), Barine (2012), Ramachandran and Janakirman (2009), Fazzari and Peterson (1998), Quayyum (2011) and Riwo *et al.* (2013). Realize on the importance of working capital management, this study try to examine the relationship of knowledge, awareness and attitudes of micro entrepreneur towards the management of working capital that can be used as approach to manage credit risk.

Based on the above discussion, it showed that there a very few study that has been conducted on credit risk management in micro business especially in Malaysia. Therefore, this study tries to fill in the gap by conducting a study on awareness and knowledge of credit risk management among micro business in Malaysia. The study, tries to identify on how types of business entity (sole-proprietorship, partnership and private limited) can influence on awareness and knowledge of credit risk management.

## MATERIALS AND METHODS

Research method is a method used for searching new and useful information for a particular topic with systematically process, analyze and interpret the information. According to Rajasekar research method are various procedures, scheme and algorithms used in research. Research methodology is a systematic way to solve a problem. In other words, the procedures that involve in explaining, describing and predicting the outcome are called as research methodology. Research methodology is necessary to design a method that will be used to solve the problem.

According to Bryman and Bell the quantitative methods consist in the systematic empirical studies which involve quantifying through the assistance of mathematics and statistics. Data is collected and transformed into numbers which are empirically tested to see if a relationship can be found in order to be able to draw conclusions from the results gained. There are several types of quantitative research such as survey research, correlational research, experimental research and cause-comparative research. Among of the advantages of use quantitative research are provides estimates of population at large, indicates the extensiveness of attitudes held by people, provides results which can be condensed to statistics, allows for statistical comparison between various group, it precision which is definitive and standardized and can answer such question as “How many?” and “How often?”.

Besides that, common approaches to quantitative research are survey. Among of types of surveys are custom surveys, mail/e-mail/internet survey, telephone surveys, self-administrated questionnaire survey and omnibus survey. The survey research is the systematic in gathering of information from respondent for the purpose of understanding or predicting some aspect of the behavior of the population of interest. The survey research is concerned with sampling, questionnaire design, questionnaire administration and data analysis. The choice of method to be used in this study is based on

Table 2: Statistic research method used by majority of previous researchers; credit risk management

| Variables    | Values (%) |
|--------------|------------|
| Quantitative | 71         |
| Qualitative  | 29         |

empirical study of previous method used by most researchers that study on credit risk management. Based on table below, it shows that 71% of the study used quantitative method in studying on credit risk management in business and only 29% study conduct on qualitative method. Indirectly, it indicates that quantitative method most preferences for previous researcher conducted the study on credit risk management (Table 2).

**Data collection method:** The data on this study will be collected by using survey questionnaire. Questionnaire was distributed among micro business entrepreneur in Negeri Sembilan. The purpose of survey among entrepreneurs is to examine on the factors that may influence credit risk awareness and credit risk management knowledge. For that, a purpose, 1000 questionnaires has been distributed to target respondents in Negeri Sembilan. After 2 times of reminder, there was 460 useful questionnaires have been returned and analyze for the study. It represents of 46% response rates which is consider acceptable for the study.

**Data analysis:** The data on this study will be analyzed by using descriptive statistics analysis and one-way between groups Analysis of Variance (ANOVA). Among of the data analyzed were Total Score of credit risk management Knowledge (TSK), total score of credit risk management Awareness (TSA) Towards group types of Business (TOB).

## RESULTS AND DISCUSSION

**Descriptive analysis of types of business:** This section will present the findings regarding types of business. Descriptive statistics analysis was employed for this part. Table 3 indicates the statistic of types of business among micro business. The number of respondent in this study was 460. Among of the answer choices given are sole-proprietorship, partnership and company.

Based on the result above, it showed that 317 respondents equivalent to 68.9% are sole-proprietorship, 77 respondents equivalent to 16.7% are partnership and 66 respondents equivalent to 14.3% are company. Indirectly, it shows that the highest number and percentage of types of business among micro business is sole-proprietorship and the lowest number and percentage is company.

**Table 3: Types of business**

| Types of business   | Frequencies | Percent |
|---------------------|-------------|---------|
| Sole-proprietorship | 317         | 68.9    |
| Partnership         | 77          | 16.7    |
| Company             | 66          | 14.3    |
| Total               | 460         | 100.0   |

**Table 4: Summary on comparing means score for group types of business**

| Variables | Type of business    | N   | Mean  | SD   | Significant value |
|-----------|---------------------|-----|-------|------|-------------------|
| TSK       | Sole-proprietorship | 317 | 47.81 | 5.40 | 0.535             |
|           | Partnership         | 77  | 48.55 | 4.92 |                   |
|           | Private limited     | 66  | 47.62 | 7.38 |                   |
| TSA       | Sole-proprietorship | 317 | 40.98 | 6.74 | 0.001***          |
|           | Partnership         | 77  | 43.87 | 6.52 |                   |
|           | Private limited     | 66  | 44.92 | 6.64 |                   |

\*\*\* = Significant at the  $\leq 0.01$

**Table 5: Multiple comparisons**

| Types of business   | Types of business   | Mean difference | Significant value |
|---------------------|---------------------|-----------------|-------------------|
| Sole-proprietorship | Partnership         | -2.89           | 0.002**           |
|                     | Private limited     | -3.21           | 0.001***          |
| Partnership         | Sole-proprietorship | 2.89            | 0.002***          |
|                     | Private limited     | -0.32           | 0.954             |
| Private limited     | Sole-proprietorship | 3.22            | 0.001***          |
|                     | Partnership         | 0.33            | 0.954             |

\*\*, \*\*\* = Significant at the  $\leq 0.05, 0.01$

**One-way between groups Analysis of Variance (ANOVA):** Analysis run by ANOVA is between independent variable of types of business and dependent variables of Total Score of Knowledge (TSK) and Total Score of Awareness (TSA). The purpose of this analysis is to compare the means score of the group. Subjects are dividing into three groups according to their types of business (Group 1: Sole-proprietorship; Group 2: Partnership; Group 3: Private limited). Then, following are the summary for result of ANOVA.

Based on Table 4, One-way between groups analysis of variance is dedicated to explore the significant difference in means score of types of business towards knowledge of micro business on credit risk management as measured by total score of knowledge. Based on the significant value indicates on table, it shows that there is no significant different in the means score of knowledge for the group analysed (Table 5).

In addition, the analysis continue in measuring the means score types of business towards awareness of micro business on credit risk management as measured by total score of awareness. It shows that there is significant different in means score which is significant value at 0.0001. Once the result show the significant different in means score, then multiple comparison table can explain the result in details. The explanation given is regarding where the significant differences lie by using Post-hoc test. Table of multiple comparisons shows which one significant different between groups.

Post-hoc comparison using the Turkey HSD test indicated that mean score for group 1 ( $M = 40.98$ ,  $SD = 6.74$ ) but was significantly different from group 2 ( $M = 43.87$ ,  $SD = 6.52$ ) and group 3 ( $M = 44.19$ ,  $SD = 6.64$ ). Group 2 ( $M = 43.87$ ,  $SD = 6.52$ ) was significantly different from group 1 ( $M = 40.98$ ,  $SD = 6.74$ ) and did not differ significantly from group 3. Group 3 ( $M = 44.19$ ,  $SD = 6.64$ ) was significantly different from group 1 ( $M = 40.98$ ,  $SD = 6.74$ ) and did not differ significantly from group 2.

### CONCLUSION

The result showed mix result between the relationship of credit risk management knowledge and awareness on different type of business. There is no significant different between credit risk management knowledge and type of business. However, in term of awareness, there is significant different between type of business. Based on mean score analysis, it shows to us that sole-proprietorship type of business has a significant differences compare to another two types of business-partnership and private limited company. However, there is no difference between partnership and private limited company. The findings show that sole-proprietorship has the lowest mean score for the awareness and knowledge credit risk management.

The findings of the study are very useful for the development of micro business industry in Malaysia. As a biggest form of SME sectors in Malaysia this study will become good indicator for further development of micro business. For the government, training and coaching services must be provided for micro business in order to increase their knowledge and awareness on credit risk management. Financial institution also can come out different lending policy for different types of business in order to mitigate their lending risk. They also may provide different types training and coaching services as regard to different type of business. For Non-profit organization that helps the entrepreneurs they also may come out with different policy for knowledge and awareness enhancement among their members.

The findings of the study are also interesting to be further explored. As it is conducted only in Negeri Sembilan it is advisable for future study to consider a bigger population. As method concern, the study only applied survey for data collection; it is advisable for future study to consider mix method approach in order to enhance the findings. Lastly, this study only focuses on knowledge and awareness of credit risk management. Therefore, future study is advisable to conduct a bigger scope of credit risk management among micro business

#### **ACKNOWLEDGEMENT**

Financial support for this study was provided by a grant from the Ministry of Education Malaysia under the Grant No: RACE/F2/555/USIM7.

#### **REFERENCES**

- Agyemang, B.E. and A.M. Kwame, 2013. The relationship between working capital management and profitability of listed manufacturing companies in Ghana. *Int. J. Bus. Soc. Res. UBSR.*, 3: 25-34.
- Alina, M.D., 2009. *Credit Analysis. Risk Assessment and Management*. Acedamy Publisher, Wyoming, USA.
- Chong, F., 2010. Evaluating the credit management of micro-enterprises. *WSEAS. Trans. Bus. Econ.*, 2: 149-159.
- Giesecke, K., 2004. Credit risk modeling and valuation: An introduction. *Credit Risk Model Manage.*, Vol. 2.
- Ivicic, L. and S. Cerovac, 2009. Credit risk assessment of corporate sector in croatia. *Financial Theor. Pract.*, 33: 373-399.
- Norell, N., 2001. How to reduce arrears in microfinance institutions. *J. Microfinance ESR. Rev.*, 3: 115-130.
- Quayyum, S.T., 2011. Effects of working capital management and liquidity: Evidence from the cement industry of Bangladesh. *J. Bus. Technol. Dhaka*, 6: 37-47.
- Rahman, M.M., 2011. Working capital management and profitability: A study on textiles industry. *ASA. Univ. Rev.*, 5: 115-132.
- Ramachandran, A. and M. Janakiraman, 2009. The relationship between working capital management efficiency and EBIT. *Managing Global Transitions*, 7: 61-74.
- Riwo, A.M., S.K. Kimeli, P.M. Nzioki and J.M. Nthiwa, 2013. Management of working capital and its effect on profitability of manufacturing companies listed on Nairobi Securities Exchange (NSE), Kenya. *Int. J. Bus. Finance Manage. Res.*, 1: 35-42.
- Roslan, A.H. and M.A. Karim, 2009. Determinants of microcredit repayment in Malaysia: The case of Agrobank. *Humanity Soc. Sci. J.*, 4: 45-52.