



## **Microfinance Services and Poverty Reduction in Sarawak, Malaysia**

**Sakiru Adebola Solarin\***

School of Economics, University of Nottingham Malaysia Jalan Broga, 43500 Semenyih, Malaysia. \*Email: [sakirusolarin@gmail.com](mailto:sakirusolarin@gmail.com)

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### **ABSTRACT**

Despite the efforts of various federal and regional governments over the years, poverty still exists in several places across the world, especially in the developing countries. Microfinance services have been promoted as viable tools to decrease poverty. Sarawak, Malaysia is an example of a region where microfinance services are being used to reduce the incidences of poverty. This paper proposes a conceptual model to understand the effect of different microfinance services on poverty reduction efforts in Sarawak, Malaysia. This paper is further expanded into research hypotheses for subsequent papers on the nexus. The model will serve as a valuable guide for approaches on using microfinance services in reducing poverty.

**Keywords:** Microfinance Services, Poverty Reduction, Sarawak, Malaysia

**JEL Classifications:** G10; G20

### **1. INTRODUCTION**

With the launching of New Economic Policy (NEP) in 1971, the government in Malaysia started its first major strategy on poverty eradication. Several policies and blueprints have been subsequently initiated to also address poverty. For instance, the Ministry of Rural Development commenced the process of alleviation of poverty in an all-inclusive manner via Program Pembangunan Rakyat Termiskih (PPRT) for the absolute poor in 1989. The program aimed at improving attitudinal change, generation of income, and direct support for housing and nutrition. A micro-credit scheme directed at absolute poor was initiated in 1992. Besides, the Rural Development Division and the Rural Planning Division of the Ministry to aid the hardcore poor was also established. Within three decades, the government was able to decrease the poverty rate in the country as well as in Sarawak.

Despite the relative success of these policies and blueprints, the emergence of a prosperous urban middle-class, poverty remains an issue, especially in certain states including Sarawak. The poverty

rate in the state decreased from an all-time high of 56.5% in 1976 to 20% in 1990 to 7.5% in 2004. However, premised on the 2019 poverty line income computation approach, Sarawak ranked third with a poverty rate at 9%, behind Sabah with a poverty rate of 19.5%, and Kelantan occupying the second position because of a poverty rate at 12.4%. The incidence of families below the poverty line income of the whole nation in 2019 was 5.6%. The poverty rate in Sarawak is anticipated to rise following the use of a new poverty line (which is now set at 2,131 ringgit as against the previous benchmark at 1,500 ringgit) and the economic consequences of COVID-19 pandemic (Bernama News, 2020).

Poverty is associated with inadequate access to social amenities including healthcare, nutrition, housing, water supply and sanitation (Iramani and Lutfi, 2021; Zulher and Ratnasih, 2021). The failure to secure steady income and employment is a major aspect of poverty associated with vulnerable groups in the state. The poorer households in the bottom 40% are mostly low-skilled, and lacking in formal training and skills, and therefore, will be disadvantaged when it comes to access to employment opportunities. If left unattended, the process of poverty is able to

create and recreate itself within a vicious circle. Moreover, poverty is no longer a rural phenomenon. There is a growing urban poor population in the state as a result of migration from the rural areas in search of employment and income opportunities.

Hence, there is a need for policies to adequately combat poverty in the state. Since there are existing policies both at the state and national level, there is a need to recognise and popularise the best policies or programmes that can effectively reduce poverty in the state. There are arguments in the literature in the favour of microfinance services (Khan et al., 2020). Microfinance services are financial services that are offered to low-income individuals or groups or those with inadequate access to mainstream financial services. Microfinance services include microcredit, microinsurance, savings and training. Microfinance has impacted positively on the lives of recipients, lift the capacity of poor households to better their economic situations (Khan et al., 2020). Hence, it is appropriate to consider the impact of microfinance services on poverty reduction in Sarawak. However, according to our knowledge, there is no paper devoted to the nexus in Sarawak. The current papers have focussed on other regions (Khan et al., 2020). There are also few papers on Malaysia (Solarin et al., 2020).

The objective of this conceptual paper is to consider the relationship between microfinance services and poverty reduction in state of Sarawak, Malaysia. Therefore, this study might stimulate empirical studies on the relationship between microfinance services and poverty reduction in state of Sarawak, Malaysia, which will eventually be beneficial to the policy makers and the low-income households.

## 2. THE ECONOMY OF SARAWAK

Sarawak is one of the two states that constitute East Malaysia. With an area covering around 124 thousand square kilometres, it is the biggest state in the country in terms of landmass. The state's population is about 2.81 million people, which makes it one of the most populated states in the nation. The gross domestic product of the state was 133 billion ringgit in 2018 (constant 2015 prices), while the economic growth rate was 2% for the same period. With a total labour force of 1.3 million people, the unemployment rate was 3.1% in 2019. Primary sector, namely, forestry, fishing and agriculture played vital role in providing employment opportunities to the workers in the state. Secondary sector including manufacturing sector, electricity, gas and water supply and construction also provide employment for sizeable number of employees.<sup>1</sup>

### 2.1. Providers of Microfinance Services in Sarawak

#### 2.1.1. Amanah Ikhtiar Malaysia (AIM)

AIM, which was created in 1987 is the largest microfinance organisation in the country. The central objective for the establishment of AIM is to decrease poverty in the country via the delivery of interest free or low interest microcredit services to the low-income and poor families to invest in income-generating

activities and therefore enhance their standard of living. It offers continuous financial, guidance and training to entrepreneurs from poor and low-income households and produce entrepreneurs from poor and low-income circles. Cumulatively, for 32 years, AIM has granted around 24 billion ringgit and in 2019, about 2.6 billion ringgits credit facility was granted. It currently boasts of 380,563 active borrowers. It has a regional office in Sarawak, which caters for the low-income groups in the state. The office provides all the necessary services in Sarawak. Among the specific programmes of the agency are:

- a. Ikhtiar financing scheme, which is a scheme meant for granting loans to households with income that is below 3,855 ringgit. The minimum credit is 1,000 ringgit and the maximum credit granted is 30,000 ringgit. i-Mesra, i-Srikandi, i-Wibawa, i-Sejahtera, i-Bestari and i-Penyayang are different sub-schemes under the Ikhtiar financing scheme. They differ based on loan amount granted as well as the repayment period
- b. Tabung Kebajikan & Kesejahteraan Sahabat (TKKS) is a fund set up by AIM for the purpose of the welfare and well-being of low-income individuals. Started in 2006, the fund is meant to support borrowers who are experiencing difficulties in their livelihoods as a result of accidents, deaths, chronic diseases, illnesses or unexpected losses as a result of natural disasters. Participants voluntarily contribute a certain amount on a monthly while AIM contributes annually to this fund, which can be withdrawn during times of need
- c. Compulsory savings or group funds scheme, which is a scheme set up to instil good savings habits and create group funds. It requires the participants to contribute about 1 ringgit to 33 ringgit on a weekly basis. The savings are turned into shares among the participants. The total financing rendered to each member depends on the number of months that the member has been a participant. The minimum amount of financing is 1,000 ringgit, while the maximum amount of financing is 30,000 ringgit.<sup>2</sup>

#### 2.1.2. Tabung Ekonomi Kumpulan Usaha Niaga (TEKUN)

TEKUN was established on 9 November 1998 and is a department under the purview of the Ministry of Entrepreneurial and Cooperative Development. The purpose of launching TEKUN is to offer basic and speedy financing services to bumiputeras in a bid to commence and further develop their companies. Currently, TEKUN Nasional is under the purview of the Ministry of Entrepreneur Development. The agency offers microcredit that is easy, fast and entrepreneur-friendly. It also offers support services and guidance to TEKUN entrepreneurs. Furthermore, it facilitates entrepreneurial networks and communities. It also nurtures entrepreneurial ethics and promote the practice of savings among clients. It also makes sure that credit granted to clients are recollected on time so that it can be reallocated to other clients. It has a regional office in Sarawak, which caters for the low-income groups in the state. The office provides all the necessary services in Sarawak. Among the specific programmes of the agency are:

- a. TEKUN NIAGA financing scheme is a scheme which provides small loan scheme (between 10,000 and 50,000 ringgit) and medium loan scheme (between 50,000 and 100,000 ringgit).

<sup>1</sup> [https://www.dosm.gov.my/v1/index.php?r=column/cone&menu\\_id=cJnWTITbWFHdmUwbmtSTE1EQStfZz09](https://www.dosm.gov.my/v1/index.php?r=column/cone&menu_id=cJnWTITbWFHdmUwbmtSTE1EQStfZz09)

<sup>2</sup> <https://www.aim.gov.my/>

- While the small loan scheme allows a repayment period of up to 5 years, the medium loan scheme allows a repayment period of up to 10 years
- b. TEMAN TEKUN financing scheme is a scheme which provides Bumiputera or Indian community small loan scheme (between 10,000 and 50,000 ringgit) and medium loan scheme (between 50,000 and 100,000 ringgit). While the small loan scheme allows a repayment period from 6 months to 5 years, the medium loan scheme allows a repayment period from 6 months to 10 years
  - c. TEMANNITA financing scheme is a scheme which provides Bumiputera female to access group financing swiftly, efficiently and without difficulty for business purposes. The first financing given ranges from 1,000 ringgit to 10,000 ringgit, while additional financing of up to 20,000 ringgit is provided. The financing period ranges from 6 months to 5 years
  - d. KONTRAK-I financing scheme is a scheme which involves financing direct supplies contracts obtained from the government by entrepreneurs. Total financing of 1,000 ringgit to 100,000.00 ringgit is provided and the contract financing period is up to 6 months
  - e. Indian community entrepreneur development scheme is a scheme which provides small loan scheme (between 10,000 and 50,000 ringgit) and medium loan scheme (between 50,000 and 100,000 ringgit). While the small loan scheme allows a repayment period of up to 5 years, the medium loan scheme allows a repayment period of up to 10 years.

### 2.1.3. Sarawak micro credit scheme

This is scheme initiated by the state government of Sarawak, which grants credit to low-income entrepreneurs. The scheme is divided into Skim Kredit Mikro Sarawak (SKMS) I and II. SKMS I offers financing or credits of 1,000 ringgit to 10,000 ringgit, with no profit rate or interest to entrepreneurs from the B40 (low-income) group that are into manufacturing, services or non-primary agricultural business ventures are in need of capital to enhance their business capability and capacity. The tenure of the financing is for 1-3 years. SKMS II offers financing of 5,000 ringgit to 50,000 ringgit, with profit rates or interest of 4% based on the reduced monthly balance to small-scale and micro-entrepreneurs. The tenure of the financing is for 1-5 years.<sup>3</sup>

## 3. LITERATURE REVIEW

Several studies have concentrated on the impacts of microfinance services on poverty reduction and welfare. Since poverty is more prevalent in the developing countries, most of the existing studies have focussed developing nations. There are several factors that have been identified in the literature. Imai et al. (2012) examined the impact of microfinance service-loan portfolio on poverty reduction in 61 countries in 2003 and 2007. Using ordinary least squares and two stage least squares, the empirical findings reveal that loan provided to clients in these countries led to reduction in countries. Electrinn et al. (2013) focussed on the impact of microfinance services

on poverty alleviation in a county in Kenya-Kisii. Using a multiple regression analysis, the findings revealed that personal savings of the residents, training services and finally insurance are successful tools to combat poverty. Kimengsi et al. (2020) investigated the relationship between microfinance services and poverty alleviation among rural women in Cameroon. Using binary logistic regression method, the findings suggest that trainings plus credit provided by microfinance institutions decrease poverty in the community.

There are also studies on the relationship between microfinance services and poverty alleviation in Malaysia. For instance, Samer et al. (2013) examined the impact of microfinance services on poverty alleviation in Malaysia. Using a multinomial logistic, the results show that microfinance services including business training, savings and microcredit are essential services that reduce poverty in the Malaysia. Mamun et al. (2015) used regression analysis to show that enterprise development training, microcredit and startup motives improve the performance of micro-enterprise. Terano et al. (2015) investigated the impact of microcredit on poverty alleviation in three different areas in Malaysia- Kuala Selangor, Hulu Langat and Gombak. Using multiple linear regression, it is shown that microcredit decreases poverty among low-income earners in these areas. Three different dimensions of microcredit that are found to be effective are duration of loans received, amount of loans and number of employees.

Solarin et al. (2020) investigated the effect of microfinance services on the socio-economic welfare of low-income earners in Sabah, Malaysia. Using a regression analysis, the results show that training, microcredit, savings, micro insurance, and social intermediation service reduces poverty among the low-income earners covered in the study. The foregoing literature review indicates that there is no study on the impact of microfinance services on poverty alleviation in Sarawak, Malaysia.

## 4. RESEARCH METHODOLOGY

### 4.1. Modelling strategy

Based on literature review and the available microfinance services in Sarawak, the following equation is testable:

$$POVERTY = \xi_0 CREDIT + \xi_1 TRAINING + \xi_2 SAVINGS + \xi_3 INSURANCE + v \quad (1)$$

Where *POVERTY* is the poverty line income of the recipients of the microfinance services. *CREDIT* is the microcredit received by the recipients of the microfinance services. *TRAINING* is the training services received by recipients from the microfinance institutions. *SAVINGS* is the savings services obtained by recipients from the microfinance institutions. *INSURANCE* is the insurance service provided by microfinance institutions to its clients in Sarawak. The following hypotheses are testable:

- H<sub>1</sub>: Microcredit has an effect on the poverty
- H<sub>2</sub>: Training has an effect on the poverty
- H<sub>3</sub>: Savings has an effect on the poverty
- H<sub>4</sub>: Insurance has an effect on the poverty.

<sup>3</sup> <https://www.sedc.com.my/images/skim-covid/SMCS-Brochure.pdf>

## 5. CONCLUSION

This paper initiates a conceptual model to understand the effects of various microfinance services on poverty reduction in Sarawak, Malaysia. This paper is then extended into research hypotheses for subsequent papers on the nexus. The model will serve as a valuable guide for approaches on using microfinance services in reducing poverty. This research could also be extended to incorporate more microfinance services, which are relevant to Sarawak and other regions in the country. The introduction of mediating variable(s) into the model will further enrich it. The study can also be extended to include other states in Malaysia

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