# Country Focus Note:
# Malaysia

The objective of this note is to provide readers with an overview of financial inclusion in Malaysia. The note begins with an examination of the current state of financial inclusion in the country. It moves on to recent trends that have been driving usage in the financial sector. The note concludes by a view of the challenges that limit financial inclusion, and the opportunities that exist to unlock the potential of fintechs.

**31.2 Million**
Population

**0.2 Million**
Population with income <USD 2 per day

**10.2 Million**
Population with income <USD 10 per day

**25.99%**
Rural population

**94.6%**
Adult literacy level

**137.8%**
Mobile penetration

**81%**
Banked population

**4.9%**
Gender gap in ownership of bank accounts

| Key Trends: Savings | Key Trends: Credit |
|---|---|
| • 81.6% of the population save money, of which only a third save at a formal financial institution.<br>• Cost, distance and lack of documentation are some of the key barriers for low-income customers. | • Ranked at 21 globally in terms of ease of access to loans.<br>• 59.3% of the population avail credit, of which nearly a third avails credit from formal financial institutions.<br>• 76.4% of the adults are under credit bureau coverage. |

## General Business Environment

**#24**
Ranked on ease of doing business index

**#9**
Ranked on availability of venture capital

**100%**
of the population has access to electricity

**78.8%**
of the population has access to the Internet

**USD 7.16 Billion**
Total value of digital payments in 2017

**USD 142 Billion**
Total value of mobile payments in 2017

| Key Trends: SME Sector | | | | | |
|---|---|---|---|---|---|
| | **32.7%** Contribution to GDP | **57.5%** Contribution to employment | **10.2%** SME claim access to finance as major barrier | **USD 8 Bn** Total credit gap in SME sector | **USD 126,000** Average credit gap per SME |

# Status of Financial Inclusion in Malaysia[1,2]

Malaysia has made significant progress towards financial inclusion in the recent past, owing to conducive regulations, innovation, and strengthening of the banking sector. The 2017 World Economic Forum (WEF) Global Competitiveness Report states that out of 137 countries, Malaysia ranks 14th based on the availability and 16th on the affordability of financial services. In the three years from 2011 to 2014, there had been a 14.5% increase in the adult population with access to a bank account. In 2014, 80.7% of all adults owned a bank account in the country as compared to 69% of adults in East Asia and Pacific. Malaysia's success in financial inclusion has been unique among most of the middle-income countries in the world. The efforts undertaken by Malaysian authorities over the past two decades have facilitated the establishment of an inclusive financial system through two key policy objectives – financial stability and financial inclusion.

Financial inclusion is a key goal of Bank Negara Malaysia (BNM), Malaysia's Central Bank, under the Central Bank Act of Malaysia 2009. Malaysia adopted a Financial Inclusion Framework under the Financial Sector Blueprint for the period 2011–2020. This blueprint aims to create an enabling and holistic ecosystem, which allows and encourages the delivery of innovative products and services to the low-income segment in a safe, effective, and sustainable manner.

Other key reforms undertaken by the government and regulator that have shaped financial inclusion in Malaysia include – setting up a credit bureau, introducing an agent banking model, reforming Development Finance Institutions (DFIs), upgrading the national payment system infrastructure and accelerating the adoption of electronic payments. As a result, most households in Malaysia now have access to a wide range of conventional and Islamic finance products and services and carry out electronic payments nationwide.

Malaysia is on track to become a high-income nation by 2020. Migrant labour, both medium and low skilled, continues to play a crucial role in the country's development. As per Malaysia Economic Monitor 2015, there are 2.1 million registered migrants in Malaysia and likely over 1 million undocumented migrants, making up 15% of Malaysia's workforce. However, the Malaysian Employers Federation estimates that the number of undocumented migrant workers could be closer to 4 million. The migrant population comprise largely of workers from the neighbouring countries of Indonesia, Bangladesh, Nepal, Myanmar, Vietnam, China, and India. They find employment mostly as third-party contract workers in sectors such as plantation agriculture, manufacturing, construction, and hospitality. Many of the undocumented workers may earn less than the minimum wage.

While the country has achieved one of the highest levels of financial inclusion among middle-income nations, the community of migrant workers lacks access to formal financial institutions and services. The 2014 Global Findex Database suggests that the unbanked population in Malaysia is largely comprised of adults living in rural areas with low education levels (primary education or less) – including migrant workers. A survey conducted by the World Bank's Project Greenback 2.0 team finds that the level of bank account ownership is 22% for plantation workers and 55% for urban workers.

- 1.5 bank branches per 10,000 adults
- 6,500 nationwide banking agents
- 5.2 ATMs per 10,000 adults
- 92% adults with a deposit account
- 18.3 million internet banking subscribers
- 41.2% adults have debit cards
- 76.4% adults covered under credit bureau

1. This document contains a few hyperlinks and readers are advised to read the document in conjunction with them.
2. The *MicroSave* report, titled Leveraging Technology for Meaningful Financial Inclusion in Asia, provides a detailed status on financial inclusion and usage of financial services in Malaysia.

The government has undertaken key policy initiatives to improve the financial health of the lower-income group or the bottom 40% of Malaysian households by income (B40). Under the BR1M or "Bantuan Rakyat 1 Malaysia" program, the B40 segment receives cash transfers up to RM1,200 (~USD 307). In 2017, BR1M benefitted 7 million recipients with an allocation of RM6.8 billion (~USD 1.74 billion).

# Key Trends in Financial Sector Usage[1]

We can summarise the current use of the key financial products in Bangladesh as follows.

## 1 There is a Strong Shift in the Savings Culture

The Financial Capability and Inclusion Demand-side Survey conducted by Bank Negara Malaysia in 2015 reported that more than 75% of Malaysians find it difficult to even raise MYR 1,000 (~USD 245) to meet emergency needs and only a quarter of Malaysians have any form of investment. There is a growing concern about the low financial literacy level of Malaysians that has been leading to a change in the culture of savings. The 2014 Global Findex Database suggests that by 2014, around 81.5% of adults reported having saved money in the past 12 months. Around 79.9% of adults in rural areas exhibited a similar savings pattern. Many adults prefer to save at institutions, such as Pilgrim Fund Board, which offer more attractive returns than conventional bank deposits.

## 2 There is High Demand for Credit Products

Malaysians have been borrowing more and saving less. Out of 137 countries, Malaysia is ranked 29th in terms of ease of access to loans. Almost half of the people in Malaysia use credit services. Of these, only 19.5% availed credit at a formal financial institution in 2014. Since 2011, there has been an increase (~9%) in terms of people availing credit services from formal financial institutions. Around 39% of adults reported borrowing money from friends and family. Access to formal credit for the low-income population has improved. In 2014, 15% of the poorest 40% of the population availed credit from a financial institution as compared to only 3% in 2011.

The expansion of credit in the country has resulted in higher household indebtedness levels (89.1% of GDP). According to available data, home-buyers' schemes like the 1Malaysia People's Housing Programme (PR1MA), higher loan limits for civil servants and higher inflation could further raise household debt. BNM has issued Responsible Lending Guideline, which limits individuals' ability to leverage available products. However, there is still considerable unmet demand for working capital credit for SMEs in the country.

## 3 BNM's Efforts are Driving a Noticeable Shift Towards Digital Payments

Despite the availability of a modern and secure payment system, Malaysians still use cash extensively. Under the Financial Sector Blueprint 2011–2020, BNM aims to enhance the payments infrastructure to realise better coverage, faster settlements, and efficient payment services. As a part of the blueprint, the central bank has undertaken multiple initiatives to reduce the use of cash and other paper-based instruments by encouraging the use of debit cards and mobile-based payment solutions. These initiatives have successfully enabled more than two-thirds of the population to transact digitally.

According to BNM's data for 2016, there were 9 million credit cards, 44 million debit cards, and 61 million e-money accounts (including prepaid cards) in circulation. The total number of electronic payments per capita increased to 97 in 2016 compared to 49 in 2011 owing to increase in card transactions and credit transfers. The penetration of internet banking and mobile banking among the adult population stood at 72% and 28% respectively.

# Challenges that Limit Meaningful Financial Inclusion

## Sectoral Challenges

- High Turnaround Time: The decision-making process at banks can be slow and often involves many steps. Banks have not universally adopted the use of fintech to more quickly process requests.
- Urban Focus: As most fintechs continue to focus on serving the urban and middle-income or affluent market segments, it is difficult for them to prioritize the low-income markets' needs. Most of the fintechs focus on the payments space, offering reduced transaction costs and increased convenience. Many are start-ups with limited bandwidth or budget to invest in any kind of marketing activities outside of Kuala Lumpur.
- Cost: The cost of the remittance license required by formal banks can be too expensive for the fintech teams looking to enter this space. As a result, they partner with licensed money transfer companies, which tend to concentrate on back-end operations instead of customer-facing processes.
- Skill: Another crucial challenge is that of finding suitably skilled staff for fintech jobs, with many of the tech-savvy lured away to other international markets. BNM recognised this and started the 'Fintech Hacks' programme that conducts roadshows at local universities to spur interest among the youth and inspire the development of Malaysia-based solutions.

## Challenges Related to the Design and Delivery of Financial Services

| Product | Outstanding Constraints |
|---|---|
| Remittances | • Access to formal financial institutions continues to be a substantial problem for the migrant labour force.<br>• Migrant workers prefer non-bank remittance service providers to banks owing to the convenience of location, ease of transaction, and speed and reliability of the channel. |
| Credit | • Low-income customers and microenterprises cannot avail formal credit services because they are unable to offer the necessary collaterals or navigate the complex documentation processes.<br>• Most of the formal credit supply is concentrated in Kuala Lumpur and other major cities. The credit gap is viewed to be the largest for SMEs outside the Klang Valley (Greater Kuala Lumpur area). |
| Savings | • BNM's Guidelines on Responsible Financing mandate physical verification of KYC documents of customers at bank branches – creating an impediment to expanding access to savings accounts for rural and remote low-income clients who could otherwise use the agent banking channel. |
| Insurance | • There is considerable unmet demand for traditional and micro-insurance products among low-income customers.<br>• The 1Malaysia Micro Protection Plan (1MMPP), may reach the low-income, however, the per capita sum assured of MYR 41,055 (~USD 10,053) is below the amount needed to support one family member in the event of the death or disability of the breadwinner. |

# Opportunities to Unlock the Potential of Fintech

Fintech is already playing an important role to drive financial inclusion in Malaysia and this seems set to accelerate because of BNM's enabling approach to fintech.

Banks in Malaysia have a keen interest in supporting fintech through initiatives, such as accelerators or innovation labs. Maybank, the largest bank by market share in Malaysia, provides a platform for innovators to highlight their ideas. Another large bank, CIMB, launched its incubation programme, 'Innochallenge', in 2015 to ideate and create new fintech solutions by mentoring start-ups. RHB Bank plans to evaluate, fund, and mentor fintechs by organising hackathons and has planned to set aside 20% of its capital expenditure on executing new digital strategies.

As part of recent developments, Maybank and CIMB have also entered into a partnership with Ant Financial Services Group, wherein they would act as the settlement and merchant acquirer bank to enable an Alipay mobile wallet in Malaysia.

### BNM's Efforts to Build a Conducive Environment for Fintechs

BNM has been proactive in recognising fintechs as a catalyst for the development of progressive financial services. Its efforts have included an increasing focus on the use of technology. The Central Bank established the Financial Technology Enabler Group (FTEG) and issued a Financial Technology Regulatory Sandbox Framework. The FTEG has been designed as a cross-functional group to serve as the focal contact point on fintech-related queries. The sandbox framework grants regulatory flexibilities to financial institutions and fintechs to test new solutions in a live, contained environment within specified timeframes and parameters.

The fintech players in Malaysia have a huge potential to address most of the constraints highlighted before. Outlined in the following section are some ways in which fintechs can address product-specific challenges.

## Digital Literacy and Meaningful Financial Awareness

Limited digital literacy and financial awareness remain as significant challenges even in countries such as China and Malaysia that have well- developed financial systems. Poor financial awareness limits the ability of the lower-income segments to make informed decisions concerning their household and business finances.

Earlier in April 2017, Encik Abdul Rasheed Ghaffour, Deputy Governor of BNM, highlighted growing concerns about the low financial literacy levels of Malaysians as measured by financial knowledge, attitudes, and behaviours. The Deputy Governor also placed emphasis on building the financial capability and literacy of Malaysians to improve the well-being of individuals and households, ensure a sound and competitive financial system, as well as contribute to the sustainable growth of the economy.

BNM along with incumbent financial service providers and fintechs can contribute solutions by creating intuitive interfaces and use-cases to help people learn how to use technology to manage their finances. Moreover, targeted financial capability campaigns (literacy plus action) can be designed for segments such as migrant foreign labourers or plantation workers, who are neither highly educated nor aware of new digital payment technologies..

## Technology-backed Remittance Solutions for Migrant Workers[3]

Access to formal financial institutions is a substantial problem for the migrant labour force due to the lack of proper documentation, payment of wages in cash, an inability to maintain the required 'minimum deposit', and remoteness of their work locations from the nearest bank branch. The findings of the Project Greenback 2.0 survey indicate that migrant workers prefer non-bank remittance service providers to banks because of the convenience of location, ease of transaction, and speed and reliability of the channel.

3. Refer to MicroSave's blog on "Potential for Technology-backed Remittance Solutions in Malaysia".

One of the most significant trends in technology among the migrant worker community in Malaysia has been the increase in smartphone adoption, largely driven by the reduced cost of smartphones and greater access to mobile broadband. The migrant community uses smartphones to access social media platforms to connect with their families back home. This has made them increasingly comfortable with using technology for financial services as well. This presents a great opportunity for financial institutions to provide access to technology-driven, innovative remittance services

## Meaningful Partnerships between Fintechs and Financial Service Providers

While fintechs are in the market and able to deliver financial services with greater speed, affordability and efficiency, most innovations currently focus on the middle and upper-income market segments, which are most valuable for start-up fintechs. There is an increasing number of fintechs that seek to address the lower income, mass-market segments and explore new and sustainable business models to do so.

Most fintechs currently have singular product offerings that enable them to articulate their product clearly. The existing FSPs offer multiple products and have the depth of experience, access to capital, and regulatory capabilities to serve many more people. Meaningful partnerships between fintechs and FSPs would potentially combine the skills, abilities, and innovation needed to achieve greater financial inclusion in Malaysia. Each of the sides still views the other warily but is beginning to communicate more.

## Credit Risk-assessment for SMEs

Small and medium enterprises (SMEs) are a major driver of economic growth and job creation in most developing and developed economies. In Malaysia too, SMEs play an important role by fostering entrepreneurship and innovation, enhancing economic dynamism, creating value chains, and developing the financial market. As per Asian Development Bank's Asia SME Finance Monitor 2014, SMEs in Malaysia contributed to 32.7% of the country's GDP and constituted 57.5% of the total employees in the country. However, 10.2% of the SMEs claimed that access to finance is a major barrier to doing business in the country. The credit gap is viewed to be the largest for SMEs outside the Klang Valley (Greater Kuala Lumpur area).

At a time when digital technology is reshaping the financial services industry and accelerating the pace of financial inclusion, fintechs see a clear opportunity in SME financing and a compelling proposition to serve this market through technology. Many active fintechs have been using non-traditional data to enable credit scoring. Types of such non-traditional data include payment transaction data, insights based on psychometric tests, telecom data, and geo-positional information. These alternative data sources help fintechs assess the credit risks of entities who may not have a credit history, established formal banking relationships, or verifiable sources of income. As a result, the fintechs can facilitate formal credit for previously excluded potential borrowers who rely on informal sources for loans.

# Looking Ahead

Given BNM's proactive stance and an active collaboration between fintechs and incumbent financial service providers, we expect technology-driven and innovative solutions to emerge in Malaysia, creating a differentiated and compelling suite of product and service offerings. These solutions will augment meaningful financial inclusion in the country and facilitate the integration of underserved segments, including migrant workers, into the formal financial services sector.

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This note is part of a series highlighting the findings of a ***MicroSave*** study supported by MetLife Foundation. The study focused on understanding how technology could be meaningfully leveraged to advance financial inclusion across six markets in Asia – Bangladesh, China, Malaysia, Myanmar, Nepal, and Vietnam.