

Legal Governance of Microfinance in Malaysia: Addressing Borrower Default Through Tiered Enforcement and Institutional Sustainability

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ABSTRACT

Microfinance plays a pivotal role in supporting Malaysia's small enterprises and financially underserved communities. Yet, borrower defaults pose a significant threat to institutional sustainability and financial inclusion. This article examines the role of legal enforcement in addressing borrower default and promoting good governance among Malaysian microfinance institutions. Using a doctrinal legal approach, complemented by qualitative interviews with five major related institutions, the study analyses enforcement mechanisms ranging from civil litigation to bankruptcy proceedings. It also investigates institutional practices and borrower categorization in the context of contractual obligations. The findings reveal that while legal action is an important tool for protecting institutional integrity, alternative strategies such as borrower education, community-based monitoring, and adaptive repayment structures offer complementary pathways to sustainability. The study concludes that an integrated legal-governance framework, combining enforcement with borrower-centric approaches, is essential for enhancing microfinance institutions resilience and policy alignment with the government financial inclusion agenda.

Keywords: Microfinance Governance, Borrower Default, Legal Enforcement, Institutional Sustainability, Malaysia

INTRODUCTION

The legal system significantly impacts the economy and the market economy model (Hadfield, Gillian K., 2022). Legal systems can facilitate the functioning of the regulatory environment through a long tradition of institutions (Quayes & Joseph, 2021). The rule of law in a country is important to the contribution of economic growth. Regulations and policies by the government may impact the operations of different institutions as well as MFIs (Hussain et al., 2021). Microfinance institution policies can protect the financial system depositors and make the financial institution more competitive, assisting the poor (Clacher Lain et al., 2006). The ability of the institution to utilise the borrower's financial resources and maintain its survival would be harmed by poor lending procedures (Mugisha, 1995). Breth (1999) also emphasized that before a contract is signed, requirements such as collateral, legal action, and a penalty need to be well explained to the borrower to ensure that the institution can track the borrower in a default payment. It is also a risk control measure on the part of the institution (Breth, 1998). Furthermore, a study by Myers (1999) states that the existence of collateral asset requirements means legal action in court will ensure mandatory payment by the borrower.

When a failure to pay a loan necessitates judicial intervention, one of the strategies utilized by a financing institution to realize securities is to pursue legal action (Myers, 1998). Elaborate more on legal action. Legal action is initiated against the borrower and guarantor(s) to recover any amounts owed, but usually, after the designated collateral has been seized and offset against the indebtedness (Anthony Siaw et al., 2014). Any microfinance institution in Malaysia may take legal action to obtain an order from the court to recover the unpaid balance from a defaulting borrower. Findings from the interview with the MFIs in Malaysia recognised legal action as an effective tool in the institution to resolve the issue of the borrower's attitude toward loan

repayment. Legal action served as a penalty to the defaulting borrower which will ensure the financial soundness of the MFIs. The prospects of the MFIs collecting the outstanding amount from the borrower are improved through legal action. The MFIs won't be able to continue operating sustainably in the absence of legal action.

The microfinance institution's inability to create financing returns will impact the institution and raise the cost burden on the financing (Central Bank of Kenya, 2007). Solli et al. (2015) recognized the importance of legal action for people who could afford to pay the loan but were unwilling to repay. According to Quayes and Joseph (2017), countries with code law systems outperform those with common law systems in the microfinance industry. Code law countries have a well-defined regulated environment whereas common law countries exhibit a less regulated financial market that relies heavily on an effective judicial system (Quayes and Joseph (2017). A legal system based on code law can formally regulate and authenticate the services of an MFI, for example. Validating MFIs by equating them with 'banks' and creating the perceptions of credibility and wider acceptance (Ferrand,2013) Malaysia is a common law country with a distinct common law-based legal system (Shabanaj, 2017). The Contracts Act 1950 codifies the law of contracts in Malaysia and describes the procedures for entering into a contract as well as the conditions under which a contract is enforceable. Civil Law 1956 provides rules and regulations for civil procedure which is executed in Malaysian court. A defaulting borrower in Malaysia faces legal action due to a contractual breach between the borrower and the financier. When a borrower fails to repay a finance loan, he or she is said to have defaulted. Financial institutions must take legal action which is conducted in a court having jurisdiction over contractual disputes to ensure that the harm caused by the breach is recoverable,

MFIs in Malaysia are divided into two categories which are profit-driven microfinance institutions and non-profit lending microfinance institutions. Profit-driven microfinance institutions are the only ones who take legal action against the borrower. While the borrower is protected from legal action by the non-profit lending microfinance institutions. The MFIs classified the borrower into two groups. Borrowers earning less than RM4,000.00 make up the initial category of microfinance borrowers in Malaysia. The second group consists of entrepreneurs with a business that generates more than RM4,000.00 in revenue but requires more capital to expand the business. The financial institution provides borrowers with loan agreements after the loan has been approved. The legal action conducted against defaulting borrowers formally demands repayment of the loan. The MFIs classified the defaulting borrowers into two types. The first ones are those who fail to make payments due to a failed business strategy and the second ones are those who are reckless and refuse to make payments although their business is thriving and profitable. This article will focus on the second group of borrowers who purposefully do not settle payments without reasonable cause, although making a profit.

The remainder of this paper is structured as follows. The second section discusses the significance of legal action to microfinance institutions. The third section analyse the causes of loan delinquency. The fourth section presents the steps in legal procedure taken by the defaulter. Section five illustrates the relationship between legal action and borrower repayment rates in microfinance. The data from this study came from five sizeable Malaysian microfinance institutions.

Legal And Institutional Framework For Microfinance

Microfinance in Malaysia is governed under the Contracts Act 1950 and Civil Law Act 1956, which provide enforceable foundations for loan agreements and judicial remedies. The regulatory oversight by Bank Negara Malaysia includes credit reporting, borrower monitoring systems, and governance standards.

Table 1 below summarizes key legal instruments and enforcement tools relevant to MFIs:

Legal Instrument	Scope	Applies To	Enforcement Tool
Contracts Act 1950	All private contracts	All MFIs	Civil suits for breach
Civil Law Act 1956	Civil court procedures	All MFIs	Summons, garnishment, foreclosure

Insolvency Act 1967	Debt > RM100k	All MFIs	Bankruptcy proceedings
Policy Document on Micro Finance Scheme 2024	Credit reporting & compliance	Licensed MFIs By Bank Negara Malaysia	Governance monitoring

Source : Authors Own

Significance Of Legal Action To Microfinance Institution

The law plays a role in determining the governance, rights, responsibilities, and liabilities of the parties concerned. Additionally, it also protects the rights of institutions and depositors, assisting banks in collecting data containing borrowers' credit information. As a result systematic financing systems and legal action procedures against defaulting borrowers to ensure fairness for all parties.

Governance Of Microfinance Institution

The main requirement from a legal standpoint is to regulate activities and the implementation of policy determined by the microfinance institution. Every aspect of financing activities involves parties such as institutions, borrowers, and investors for institutions that use investment funds. There are normally four main sources of social capital available which are NGOs, government organisations, specialist equity funds, and a small number of private investors (Rock et al 1998). Good governance structure of an MFI arbitrates the interest of its diverse stakeholders and safeguards its viability and financial sustainability (Kassim et al 2018)

Governance usually refers to how the rights/claims and obligations are divided among the stakeholders of the institution. It deals with who owns the institution who is responsible for the daily management of the institution and what (internal as well as external) mechanisms are in place to make sure that the interests of the stakeholders are taken care of by the management of the institution (Hermes et al, 2018)

Governance of MFIs is explained as a system of checks and balances whereby a board of directors is established to oversee the management of the MFI (Ledgerwood,1999). The responsibility of the board is to serve and protect the interests of not only the shareholders but also all stakeholders of the organization including clients, employees, and creditors. The main responsibility of the board is to appoint and supervise the senior leadership team of the organization (Armenda´riz and Morduch, 2010). The board must understand the vision and ensure that it is carried out. Management, on the other hand, is involved in the day-to-day operations of carrying out the vision. Given the increased scrutiny of stakeholders at the MFI level, the changing marketplace, and growing public expectations and demand for accountability, good governance is critical (Bakker et al, 2014). Microfinance governance is challenging and different from other type of loan. The distinctions are four distinct features: the dual mission of microfinance—achieving profitability while maintaining a social objective; MFI ownership; fiduciary responsibility of the board; and risk assessment in MFIs (Rock et al. 1998).

Governance is also determined by the legal system. The legal system ensures that microfinance institutions are open, honest, and efficient to safeguard financiers' rights and retrieve the outstanding loan amount. It helps improve the microfinance industry's function by allowing financiers to disburse loans without worrying about retrieving the outstanding amount. A robust legal system is beneficial to countries with more substantial long-term economic growth. Furthermore, microfinance institutions with transparent and integrity governance prevent fraud by improving transparency in funding accounts and transaction reports and operational and financial sustainability (Meagher, 2002). As a result, the law plays a role in determining the procedures and governance of a microfinance institution. The law must also consider how to protect the parties in the event of a breach in the microfinance activities.

A strong governance allows the microfinance industry to remain competitive, benefit the target group, and achieve the goal of poverty reduction.

Rights, Responsibilities, And Liabilities of Parties In Microfinance

Microfinance organizations play a critical role in supplying borrowers with funding. Legal action imposed by the microfinance institution may educate borrowers about the need for repayment by cultivating and establishing a responsible attitude on the borrower to ensure those loan repayments are on time. Microfinance institutions are also involved in promoting capacity building, financial literacy, education, and training among borrowers. The MFI must provide good supervision and monitoring in order to manage default. Supervision here refers to an adequate oversight mechanism which is critical for the proper framing of microfinance activity (Anne, 2012). MFI here needs to emphasize how crucial it is for the borrower to make the loan repayments. Microfinance institutions are encouraged to build strong connections with the borrowers due to the important duties to ensure that borrowers do not neglect the duty to complete the loan payment. The institution's monitoring process aids in raising borrowers' awareness of their responsibilities to make repayments. As a result, two-way communication is critical in strengthening the bond between microfinance institutions and borrowers.

Microfinance institutions face a significant barrier where the role of educating borrowers begins as the loan is released to the borrowers. After the disbursement of the loan to the borrower, each of these microfinance institution officers attempts to visit the business location to examine whether the loan follows the proposed business plan. The borrower is required to be present at the premises by scheduled appointment. Frequent visits to borrowers foster the borrowers' loyalty and it may serve as a constant reminder that borrowers must keep their promises to pay the loan on time to avoid legal action. The borrower must pay the loan back on the set date each month when the loan is due.

Short courses conducted by the MFI are among the necessary alternatives to explain the procedure of legal action resulting from the breach of contract. This is to educate the borrower's responsibility and foster a responsible attitude toward borrowers. Apart from that MFI may also conduct regular site visits, communicate, and establish good connections with borrowers because some of the borrowers lack a solid educational foundation thus they must be guided from all aspects of the business to ensure that the business is systematized. Borrowers should be encouraged to boost their businesses' revenue to enable them to maintain regular payments to microfinance institutions. As a result, this attempt will lower the default rate.

Depositors And Institutional Rights

The protection of institutional and depositor rights through a systematic loan repayment procedure following the law and a contract signed by both parties. Depositors can be individuals and households, financial and nonfinancial firms, or national and local governments (IMF). They are not in a position to monitor the institution's financial soundness. Therefore, the demand to reclaim the unpaid payment from the defaulting borrower is made through court action. Furthermore, the institution will be able to reclaim the outstanding amount, which will be advantageous to provide to new potential borrowers. It aids in preventing continued losses to institutions and depositors, which could lead to the institution's discontinuing microfinance activities. Microfinance institutions can maintain their sustainability and viability by enforcing legal action against defaulting borrowers.

If the loan cycle and loan repayments go smoothly, the microfinance industry will be able to maintain its viability and extend its potential. Without a clear and effective mechanism for recovering the loan amount, defaulting borrowers may cause disruption and threaten the industry's continued existence. The legal institution's role is critical in guaranteeing that the microfinance institution can reclaim the outstanding amount due from the irresponsible and defaulting borrower without difficulty. Court litigation ensures mandatory repayment of principal apart from the collateral assets (Myers, 1998). The legal system enhanced the legitimacy of the microfinance sector with the client.

Data Collection of Borrower's Credit Information to Build A Systematic And Organized Funding System

The law's implementation through an adequate legal framework assists microfinance institutions in collecting data and completing the information to establish a more detailed record for the microfinance sector. It aided microfinance institutions in better managing their businesses and being competitive for more extended periods because all microfinance institutions in Malaysia had complete data on borrowers' credit information. All microfinance organizations now have a network system that is interconnected and holds the credit information of the borrowers. The credit information provided by the borrower assists banks in determining loan approvals based on the borrower's credit information system. For example, if a borrower faces legal action and no payment, the customer's credit history will be sent to Bank Negara Malaysia's Credit Reference System Centre (Bank Negara Malaysia, 2020).

The system is linked to all registered financial institutions and collaborates with Bank Negara Malaysia, allowing the system to release credit information to any microfinance institution upon request automatically. Credit information will be available in the system for three types of loans: cumulative loans, special attention accounts, and loan applications submitted during the previous year. The technology assists microfinance institutions in gathering credit data from borrowers, which is in one of the central systems. Borrowers pursued by the courts will go to a particular attention account. Under the Counselling and Management Credit Agency, special attention accounts contain information on overdue loans and specific debt management schedules (Bank Negara Malaysia, 2020). Borrowers with a shady or incorrect credit information system will have their loan advantages revoked.

Determinants And Challenges Of Loan Repayment In Microfinance

A substantial body of research has identified key determinants influencing loan repayment among microfinance borrowers, as well as factors contributing to loan delinquency. Profitability remains a crucial factor—borrowers generating consistent profits demonstrate higher repayment rates. Studies have shown that profitable borrowers can repay up to 70.35% of their loans, and none who accumulated profits failed to meet their repayment obligations (Norhaziah & Mohd Noor, 2012; Okorie, 1986; Wongnaa & Vitor, 2013). Business experience also plays a vital role, with experienced borrowers benefiting from strong sales networks, better business management skills, and adoption of new technologies, all of which support repayment capacity (Onyeagocha, Ezeoha, & Okafor, 2012; Shu-teng, Chien-Chiang, & Hui, 2015; Wongnaa & Vitor, 2013; Parik Mirkalan et al., 1995). The proximity of borrowers to lending institutions facilitates easier access to technical assistance and improves communication, contributing positively to repayment behavior (Bhatt & Tang, 2002; Norhaziah & Mohd Noor, 2012; Oke, Akinola, & Adedeji, 2007). Additionally, larger loan sizes encourage better repayment, as they enable borrowers to invest in productive assets and are subject to closer monitoring by financial institutions (Ali Al-Syarafat, 2013; Baklouti, 2013; Onyeagocha et al., 2012; Shu-teng et al., 2015).

Despite these positive determinants, loan delinquency remains a challenge for microfinance institutions. Various studies identify multiple risk factors that negatively impact borrowers' ability to repay. Addae-Korankye (2014) highlights operational and personal challenges such as late loan disbursement, business failure, unfavorable repayment terms, high interest rates, inadequate loan sizes, unexpected personal contingencies like illness or family death, and insufficient borrower training. Okpugie (2009) similarly underscores high interest rates as a major deterrent to repayment. Ahmad (1997) points to borrower unwillingness to repay, diversion of loan funds, willful negligence, and inadequate credit appraisal as causes of default. External economic shocks and poor decision-making, including bad weather and sudden price changes, also contribute to repayment difficulties (Gorter & Bloem, 2002). Further, Warue (2012) identifies management failure as a key internal factor, while Priyankara, Perera, and Rupasinghe (2019) include broader institutional controls, family-related issues, and macroeconomic factors that influence repayment outcomes.

Together, these findings suggest that while borrower characteristics and institutional factors support loan repayment, a complex array of internal and external challenges continue to threaten repayment performance.

Understanding these determinants and obstacles is critical for designing effective microfinance policies and governance frameworks that promote both financial inclusion and institutional sustainability.

Causes Of Borrower Default

Borrower default arises from both structural and behavioral factors. Interviews and prior literature identify business failure, high interest burdens, limited financial literacy, and willful negligence as key causes. MFIs typically classify defaulters into two groups; involuntary defaulters: affected by business downturns, health crises, or personal loss and strategic defaulters who choose not to repay despite healthy profits.

Legal Procedure Towards The Defaulting Borrower In Microfinance Institution In Malaysia

Following the approval of each microfinance loan, the first step is for the borrower and the financial institution to sign a microfinance loan agreement. The agreement lays out the terms and conditions that the borrower must follow smoothly for the loan and repayment procedure (Day et al, 1996). On the other hand, every borrower must plan and manage every business successfully. If the business can generate income as intended, this will help to simplify the loan payback process. The borrower is in default when he or she fails to meet his or her legal obligations under the loan contract. Default may occur when a borrower is unnecessarily unwilling or unable to pay their debt (Murray, 2011). If the borrower does not repay the loan within the given time frame, legal action will be conducted against the defaulting borrower (Lee Mei Pheng, 1995). The banking institution will start each legal action by filing court applications against the borrower who does not pay. The process starts with a demand letter to the borrower and continues until the financial institution has successfully recovered all outstanding amounts owed by the borrower. Every legal action taken against the borrower is based on Malaysian contract law and civil law practices.

Legal Enforcement Mechanisms

Legal action remains a dominant strategy among profit-oriented MFIs. Enforcement follows a standard progression:

- Notice of Demand & Termination
- Summons & Statement of Claim
- Judgment Debtor Summons / Garnishee Order
- Writ of Seizure & Sale / Bankruptcy

While effective for debt recovery, legal processes incur costs and delay, disproportionately affecting vulnerable borrowers.

Notice Of Demand and Termination

The financier will file a claim if the borrower fails to make a payment on his or her financing account. This claim is a formal payment request issued by the financier under the contract's provisions underlying the party issuing the demand's responsibility to fulfill. A notice of demand issued by a lawyer whom the financial institution has designated to claim the overdue loan amount will notify the borrower. The defaulting borrower has fourteen (14) days from the date of the notification of demand to pay the debt. The borrower's inability to comply with the demand notice resulted in legal action against him in a magistrate, session, or high court for the incurred debt (Lee Mei Pheng, 1995). If a borrower is in default for more than two months, a notice or letter of demand will follow standard practice, which every financial institution has followed in Malaysia. Absence response action by the borrower to make a payment of up to 4 months, a Notice of Termination will apply to the borrower. As a result of the borrower's default, a notice of termination will signal the bank's intention to terminate the loan arrangement. If the borrower does not respond to the letter of demand or notice of termination and disputes the debt, the non-response will lend credibility to the claim when the case is heard

in court. In the next four months, the borrower will receive a summons and statement of claim and must appear in court to reply to the claim.

Summons

The summons is a document sent by the court to the borrower informing them that legal action has been taken against them and asking them to appear in court by filing a notice of presence and a statement of defense. The goal is to summon the borrower to court. The lawsuit included a statement of claim that summarizes the allegation's facts. The financial institution will explain why the claim and the situation that led to the claim filing in the statement of claim. The summon will be filed in the Registry of the Court. Next, the summon must be served on the borrower by personal service or alternatively sent by prepaid registered post address to his known last address. In the event, that it is impracticable for any reason to serve the summons such the person's whereabouts cannot be traced the applicant may apply for the summons to be served by way of substitute service. The form of substitute service may be either by prepaid ordinary post letters or by advertising the substituted service in any of the leading newspapers. If the borrower files a defense, the court will fix the date for the hearing. The judge will decide once the case is called and tried in court. (Ong KB, 1995). The judgment will be recorded in court if the court determines that the borrower has no plausible defense (Lee Mei Pheng, 1995). This judgement will be recorded either as a consent judgement in the borrower's presence or as a Judgment in Default without the borrower's attendance (Ong KB, 1995).

Legal Action Procedure Towards the Defaulting Borrower

The legal action against defaulting borrowers is identical to that taken against other commercial loans such as homes, vehicles, education, and personal loans. Every year, the legislative system deals with large-scale financial claims. As a result, obtaining a judgement in default on the borrower who failed to make a repayment within the set term takes one (1) to three (3) months in the event of a microfinance loan claim. If the banking institution does not receive a payment within fourteen (14) days, the lawyer will file a bankruptcy petition or foreclose on the borrower's property.

Obtaining further orders takes approximately one (1) to three (3) months. The legal process for defaulting borrowers takes a long time, and the financial institution will have to fund the legal fees, which will be imposed on the borrower if the borrower decides to make a repayment to prevent bankruptcy and foreclosure. The reclamation of the case in this microfinance claim led the Court to take steps to improve the period for obtaining the judgment in default and bankruptcy or foreclosure of the borrower's property. They aided the financial institution in obtaining a faster repayment rate. The following section will describe the next step available after obtaining a judgment in favour of a microfinance institution to commence execution proceedings against a defaulting borrower, including bankruptcy, judgement debtors' summons, garnishee proceeding, and writ of seizure and sale.

Bankruptcy Action

The borrower with an RM 100,000.00 outstanding loan sum will face bankruptcy proceedings. In general, bankruptcy actions occur when the Insolvency Department's Official Assignee takes ownership of a borrower's assets to recover a debt for the financial institution. This procedure starts with issuing a Bankruptcy Notice when the financial institution has received a Consent Judgment or Judgment in Default from the Court for a minimum borrower's debt of RM 100,000.00. (Amendment of the Bankruptcy Act 1967). The process of a borrower being declared bankrupt by a court ruling on a creditor's petition or a debtor's petition is known as bankruptcy. All non-collateral bankrupt property is under the supervision and ownership of the Director-General of Insolvency (KPI), who is also in charge of property coordination. The proceeds of the property sale will be to creditors who have filed a debt proof form with KPI that has been certified. It is a long process for the Insolvency to call for meetings and assess the borrower's means of repaying the debts. A bankrupt must cooperate fully with the DGI in the administration of his bankruptcy, beginning with the receipt of the bankruptcy order and continuing throughout the bankruptcy period. The bankrupt must disclose information about his assets, liabilities, financial transactions, and other pertinent matters. A bankrupt is not permitted to deal with his property following section 8(1)(b) of the Insolvency Act 1967 because all of his assets and

unsecured property will be vested in DGI. As a result, all transactions and dealings with his properties must be made through the DGI, except for Malay Reserved Land, where a bankrupt has the power to realize the property and the proceeds must be given to the DGI. In the case of secured property, the bankrupt must deal directly with the secured creditor. A bankrupt is also prohibited from engaging in any dealings or transactions involving financial borrowing and selling. (Malaysian Department of Insolvency, 2020). When a Judgment Debtor is declared bankrupt, he is subject to some restrictions. For example, the Judgment Debtor is not permitted to travel abroad without the DGI's permission; he is not permitted to own any assets; he is not permitted to spend more than RM1,000 on his credit card; and he is not permitted to apply for any loans. (Malaysian Department of Insolvency, 2020).

Judgment Debtor Summons

When the microfinance institutions enforce a judgment, they are known as the judgement creditor(microfinance institution), and the opposing party is known as the judgement debtor(borrower). This is an application that can be used to discover information about the judgement debtor's assets and financial means. The debtor will be summoned to appear before the Judge/Magistrate. The Court has the authority to order the judgement debtor to pay the judgement sum in one lump sum or instalments. If the judgement debtor fails to comply with the Court order, he will be summoned again to demonstrate why he should not be imprisoned. (Office of the Chief Registrar Federal Court of Malaysia). The borrowers with outstanding loans of less than RM 10,000.00 will be served a Judgement Debtor Summons following the bank's successful acquisition of the Judgment In Default or the Consent Judgment. The borrower must comply with this lawsuit. The borrower is required to appear in court for an oath-based inspection process. The bank's solicitors will examine whether the borrower can pay the amount due if the borrower is present in court. The consent judgement will be recorded if the borrower agrees to the amount. If the borrower cannot make the payment, the borrower may request that he be interviewed orally in court as to his ability to pay the loan through the bank's solicitors. The borrower must produce all proof of water, electricity, and expenditure bills. The lawyer will ask some questions to establish the borrower's ability to pay. If the court determines that the borrower cannot make the payment as determined by the bank, the court will order the borrower to make a payment based on their ability from the order's date until the payment is completed. If a borrower fails to appear in court, an arrest warrant will be issued, and the borrower will be taken before the court (Office of the Chief Registrar Federal Court of Malaysia). Judgment Debtor Summons served as a method of discovery in aid of execution.

Garnishee proceeding

A Garnishee application can be used to attach funds owed from a judgement debtor's bank account in order to satisfy the amount owed. The Court will direct the judgement debtor's banks to seize any funds in the judgement debtor's bank account to satisfy the judgement creditor's judgement debt. (Office of the Chief Registrar Federal Court of Malaysia). The Garnishee proceeding is an enforcement method available for Creditors to recover debts from a third party within the Court's jurisdiction. When dealing with a Garnishee Order, the Creditor will work with a third party, namely the Debtor's Bank, to recover the debts owed. In this case, the Creditor should have prior knowledge of the Bank with which the Debtor was associated within the Court's jurisdiction, such as details of previous payment receipts/transactions/cheques made by the Debtor. In the event the Creditor is unable to obtain any financial information from the Debtor, the Creditor may apply to the Court, requesting that it examine the Debtor, as part of the Debtor examination process. During the court hearing, the third party will appear in Court to determine whether the Debtor has an account with the Bank, either a current or a deposit account, or whether the third party owes the Debtor money. If the third party intends to object, they must provide the Court with a reasonable and valid reason why the Garnishee Order should not be made final/absolute. The Garnishee Order will be granted by the Court if the Creditor establishes a good case and meets all of the conditions. The creditor is required to serve the Garnishee Order on the Garnishee. Following the service of the Garnishee Order, the Garnishee is required to make the payment directly to the Creditor, bypassing the Debtor. Garnishee proceedings are a simple, quick, and effective method in executing a judgement. When a Garnishee Order is served on the Garnishee, it acts as an injunction that binds the Garnishee (Moy, J. Y, 2021).

Writ Of Seizure and Sale

Borrowers whose outstanding loan balance is more significant than RM 10,000.00 but less than RM 50,000.00 will be served with Writ of Seizure and Sales. A Writ of Seizure and Sales is an application to the Court on behalf of a financial institution seeking to acquire the right to foreclosure and then sell the borrower's immovable property. Other properties that may be seized are real property, shares, vehicles, and other movable assets. The Court will direct the Sheriff or Bailiff to seize and sell the judgement debtor's property to satisfy the judgement sum due. This will be accomplished through an auction of the seized items. The proceeds will go to the Judgement Creditor. Office of the Chief Registrar Federal Court of Malaysia). After the judgement is acquired from the court, this writ is served to the borrower. This writ application aims to seize the borrower's immovable property. The judgment creditor (bank or financing institution) must pay the foreclosure and sale expenses deposit. After the court receives the deposit, a foreclosure date will be fixed. The judicial debtor's representative will accompany the bailiff to indicate the location of the seizure and identify the items. Following the execution of the seizure, the Bailiff shall provide a seizure note containing a complete list of confiscated goods. The Judgment Debtor must have a copy (Borrower). The bailiff must also keep track of any items from the premises. All sales proceeds must be recorded, and an account statement will be issued. Any third party claiming the property seized as his or her right, rather than the judgement debtor, is permitted to file a claim, and the Court will hear the application and determine who is the owner of the confiscated goods. If the confiscated goods belong to a third party, the foreclosure will be cancelled; otherwise, the foreclosure will only be continued if the goods belong to the judgement debtor. If the seized goods are worth more than RM 10,000.00, a public auctioneer will be appointed to conduct the auction. The public auctioneer will proclaim sale notices and publicize them by posting a copy on the premises or the court's notice board. The bailiff will provide an account statement detailing the proceeds of the auction, the court commission, and the auctioneer's expenses. The balance of the deposit, along with the proceeds from the sale, will be returned to the judgement creditor. The surplus from the sale will return to the judgment debtor (Office of the Chief Registrar Federal Court of Malaysia).

Microfinance Institution's Sustainability

The sustainability of microfinance institutions (MFIs) in Malaysia depends on their ability to balance financial viability with social impact. These institutions play a crucial role in providing financial access to underserved communities, particularly low-income individuals, women, and small entrepreneurs. However, the effectiveness and long-term sustainability of MFIs vary based on operational models, borrower engagement strategies, legal frameworks, and risk management practices.

In Malaysia, MFIs are broadly categorized into two groups: non-bank financial institutions and bank-affiliated institutions. Each of these institutions adopts unique approaches in terms of borrower targeting, repayment mechanisms, privileges offered, and legal enforcement. While some emphasize strict legal compliance and formal financial safeguards, others rely on community-based strategies such as peer support and close monitoring.

The table below compares five prominent Malaysian MFIs—Non-Bank A, Non-Bank B, Non-Bank C, Bank D, and Bank E—across various sustainability factors. These include their target groups, borrower privileges, legal controls, repayment enforcement methods, and support structures.

Table 1: Sustainability Factors of Microfinance Institutions in Malaysia

Factor	Non-Bank A	Non-Bank B	Non-Bank C	Bank D	Bank E
Target Group	Female	Low Income / Buddy System	Entrepreneur	Entrepreneur	Entrepreneur / Small Hawker
Privileges	Monthly Meeting	Weekly Meeting, Entrepreneurial Club, Training	Training & Courses	Training & Courses	Training & Courses
Legal Control	Contract Act 1950	Contract Act 1950	Contract Act 1950	Contract Act 1950	Contract Act 1950
Legal Action on Default	Yes	No (Focus on relationship & monitoring)	Yes	Yes	Yes
Repayment Rates	High	High (Despite no legal action)	Good	Good	Good
Group Repayment Concept	No	Yes	No	No	No
Close Monitoring	No	Yes (Weekly meetings and business tracking)	No	No	No
Payment Reschedule	No	Yes	Yes	Yes	Yes
Insurance Coverage	No (Contribution fund instead)	No	Yes	Yes	Yes

Source: Authors own.

Governance And Institutional Sustainability

Strong governance structures enable MFIs to balance legal enforcement with borrower protection. This includes board oversight, operational transparency, and credit reporting mechanisms. A comparative review of five MFIs shows differing strategies for sustainability. Non-Bank B: is social-based enforcement, no litigation, peer group monitoring. Bank D & E sort to formal litigation, insurance safeguards and loan rescheduling. Lastly, Non-Bank A & C prefer hybrid approaches with some ADR practices.

Financial Literacy And Risk Mitigation

MFIs increasingly recognize financial literacy as a preventive tool. Many conduct short courses on legal obligations, cash flow management, and credit planning. These efforts are crucial, especially for borrowers with limited education or business experience.

Alternative Dispute Resolution (Adr) In Microfinance

To reduce dependence on court proceedings, some MFIs advocate for ADR mechanisms. The Mediation via Financial Mediation Bureau, Ombudsman for Financial Services (OFS) and Community-based mediation.

Integrating ADR into MFI procedures offers quicker, cost-effective resolution, improves borrower confidence, and reduces adversarial interactions.

Fintech And The Future Of Microfinance Enforcement

The expansion of digital lending platforms such as Boost, Funding Societies necessitates regulatory adaptation. Fintech lenders operate under BNM's digital bank framework but often lack tailored microfinance safeguards. Legal frameworks must evolve to ensure responsible lending, digital contract enforceability, and borrower recourse mechanisms.

A Tiered Enforcement Model For Malaysia

The three-tiered approach to borrower default to balance legal effectiveness with borrower protection and institutional sustainability:

Stage 1: Pre-default Engagement

- Financial Education: Mandatory borrower briefings and short courses.
- Counseling: One-on-one financial advice sessions.
- Loan Rescheduling: Adjusting repayment terms based on borrower needs.

Stage 2: ADR / Mediation

- Community Mediation: Localized dispute resolution with MFI officers and borrower support groups.
- Ombudsman for Financial Services (OFS): Formal complaint channel with legally recognized settlements.
- Peer Resolution Boards: For MFIs practicing group lending and buddy systems.

Stage 3: Formal Legal Action

- Litigation: Filing summons and claims under Contracts Act 1950.

- Judgment Enforcement: Garnishee orders, Writ of Seizure and Sale, Judgment Debtor Summons.
- Insolvency Measures: Bankruptcy proceedings for debts above RM100,000.

Policy Implications & Regional Relevance

This study offers actionable insights for regulators like Bank Negara Malaysia, particularly in designing inclusive enforcement models and integrating borrower credit reporting. Furthermore, findings can support ASEAN harmonization of microfinance frameworks by illustrating how common law jurisdictions can adapt legal action within pro-poor, community-based financial ecosystems.

CONCLUSION

This study contributes to the discourse on legal governance in Malaysia's microfinance sector by offering a structured, multidimensional response to borrower default. Recognizing that rigid enforcement alone cannot ensure repayment or institutional sustainability, it is proposed a three-tiered enforcement model begin with pre-default engagement, progressing to alternative dispute resolution (ADR), and escalating to formal legal action only as a last resort. This model not only reflects the operational realities of Malaysian MFIs but also promotes proportionality, borrower dignity, and efficient resource allocation. Findings from the doctrinal analysis and field interviews reveal that legal action remains an important, albeit reactive, mechanism for reinforcing contractual obligations and safeguarding depositor interests. However, MFIs that employ non-coercive methods such as regular borrower visits, peer accountability, and financial education for better repayment outcomes, particularly in community-based institutions. The integration of digital credit systems and centralised borrower databases under Bank Negara Malaysia enhances traceability and creditworthiness assessments, enabling preventive intervention before defaults spiral into legal disputes. By embedding ADR into the formal enforcement framework and strengthening borrower literacy, policymakers and institutions can rebalance the power dynamic between lender and borrower while preserving institutional resilience. Such an approach is especially pertinent as Malaysia moves toward fintech-driven financial inclusion, where digital micro-lending must also be governed by proportionate, transparent, and borrower-sensitive legal frameworks. Ultimately, the sustainability of microfinance lies in its ability to integrate legally, socially, and institutionally. A responsive legal framework that integrates preventive education, community-based dispute resolution, and enforceable contractual recourse will be critical in safeguarding the dual mandate of MFIs namely: financial viability and social empowerment.

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