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Balancing AML/CFT Compliance and Digital Payment Innovation among Small and Medium Enterprises in Malaysia

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Abstract

The Money Services Business (MSB) Act was passed to stop money laundering and combat the funding of terrorism in Malaysia. However, the Act is limited to licensed MSB operators, like money changers and remittance providers, not SMEs in general. Many SMEs function as users of digital payment systems rather than possessing MSB licenses. This distinction is therefore important when assessing the regulatory impact. The current review study contextualises the effects of the MSB Act and more general AML/CFT regulatory requirements on the adoption of digital payments among Malaysian SMEs, with a focus on (i) licensed MSB operators and (ii) non-MSB SMEs interacting with regulated payment intermediaries. The study examines the regulatory requirements, such as Know Your Customer (KYC), Customer Due Diligence (CDD), Ongoing Due Diligence (ODD), and suspicious transaction reporting, using institutional theory, Diffusion of Innovation Theory (DIT), and Technology Acceptance Model (TAM). The results show that while non-MSB SMEs experience indirect compliance effects because of onboarding requirements, payment provider controls, and documentation demands imposed by regulated intermediaries, MSB-licensed SMEs bear a great deal of the direct compliance burdens. The article offers policy recommendations to regulatory bodies, including Bank Negara Malaysia, SMEs, payment service providers, and technology providers, to achieve a balance between financial integrity and digital payment innovation in emerging economies like Malaysia.

Keywords: Money Services Business, Online Payment Adoption, Malaysian Smes, Regulatory Compliance, AML/CFT

1. Introduction

Central bank of Malaysian had issued an act, the Money Services Business (MSB), which came into effect on September 15, 2011, to provide consumer protection, boost business opportunities, and avert the risks of money laundering and illegal practice (BNM, 2011), which was later amended on September 1, 2024, to target illegal MSB operators (BNM, 2024). The Act increases compliance across banking institutions to curb money laundering, as Malaysia is prone to financial abuse due to a high number of foreign workers and Malaysians working outside the country, and this ensures anti-money laundering and counter financing of terrorism (AML/CFT) (bin Ibrahim, 2017).

These goals are in line with international standards set by the Financial Action Task Force (FATF). The 2018 Mutual Evaluation Report (MER) reported the non-compliance in Malaysia, suggesting 40 ways of improving the AML activities, but BNM actively strives to meet the FATF recommendations (Isa et al., 2023). Such well-known instances of money laundering are 1MDB and Genneva Malaysia Sdn. Bhd., and Malaysia is in the 72nd position in the world (Yusoff et al., 2024). The 2024 annual report by BNM has focused on innovating and streamlining electronic payment transactions, with the effect of reaching a large volume of technology with the confidence of the population (Bank Negara Malaysia, 2024).

Asia-Pacific Economic Cooperation states that 96.9 percent of registered businesses in Malaysia are SMEs, with 70.1 percent micro-enterprises, 28.2 percent small firms, and 1.6 percent medium firms (APEC, 2025; SME Corporation, 2025a). A small manufacturer enterprise, small and medium-sized businesses (SME) refer to companies with a sales turnover of less than RM50 million or less than RM20 million (manufacturing and other industries, respectively) (SME corporation, 2025b). Under these limitations, SMEs suffer in their technological investment, financial technologies, compliance costs, complex operation costs, and third-party support costs. According to a recent survey conducted by SAMENTA-Ipsos, 74% of SMEs are still lagging in automation and digitalization, and 26% of them indicate that compliance as a primary burden is adding costs to operations (The Malaysian Reserve, 2025).

The MSB Act mainly applies to licensed MSB operators, such as money changers and remittance providers, not to all SMEs in general. Some MSB operators are small and medium-sized businesses (SMEs), but most Malaysian SMEs do not have a licence under the MSB Act (Yuan, 2020). However, it is important to distinguish between (i) SMEs that are licensed MSB operators and therefore directly subject to AML/CFT obligations under the MSB Act, and (ii) non-MSB SMEs that use digital payment systems as customers of regulated financial institutions. The regulatory exposure and compliance burden differ significantly between these two groups (Raof and Aziz, 2024). Although the MSB Act is beneficial in enhancing transparency and financial stability, it requires highly regulated practices that are challenging for MSB-licensed SMEs with limited resources. These regulations are licensing, KYC, CDD, ODD, and suspicious transaction reporting.

CDD is mandatory when a business needs to know its customers and keep a list of transactions that will last five years to inhibit unlawful conduct and guarantee that the code of AML/CFT is followed (BNM, 2025). Suspicious Transaction Reporting requires instant reporting of the transactions associated with money laundering, financing of terrorism, or a crime. ODD compels institutions to filter transactions and have an in-depth knowledge of customers, such as business, risk profile, economic background, and transaction purpose (BNM, 2024). Although other researchers have researched the Malaysian SMEs (Rahman et al., 2022) and the AML efficacy (Tanash, 2025), limited research explicitly distinguishes between direct regulatory obligations affecting MSB-licensed SMEs and indirect compliance effects experienced by non-MSB SMEs. This research particularly discusses the interface between regulatory compliance, adoption of technologies, and digital payment innovation among the Malaysian SMEs, with explicit differentiation between directly regulated MSB-licensed SMEs and payment-using SMEs affected indirectly through regulated intermediaries.

1.1. Problem Statement

This paper analyzes the impact of regulatory pressures, especially the MSB Act, on digital payments adoption among Malaysian SMEs. However, the impact is not uniform across all SMEs. MSB-licensed SMEs are directly subject to statutory AML/CFT compliance obligations under the Act, whereas non-MSB SMEs experience indirect regulatory effects when engaging with regulated banks and payment service providers. Online payment advantages notwithstanding, MSB-licensed SMEs are plagued by high compliance costs consisting of complicated KYC regulations, high costs of CDD and ODD, as well as advanced transaction-monitoring infrastructure to report suspicious activities. Non-MSB SMEs may face compliance-related friction in the form of enhanced onboarding documentation, transaction scrutiny, and intermediary-imposed verification requirements. SMEs that have fewer resources struggle with these burdens. The main problem is reconciling compliance with the operations and competitive positions in the market (Ismail et al., 2023).

The research questions are based on: (1) How do regulatory requirements of the MSB Act influence the adoption of digital payments by MSB-licensed SMEs? (2) Which compliance issues impact directly regulated MSB operators and indirectly affect non-MSB SMEs in relation to KYC, CDD, ODD, and suspicious transaction reporting? (3) What is the interaction between regulatory pressure and the technological and organizational factors in the decision to adopt? (4) What can be done to comply with compliance burdens with RegTech solutions (AI, blockchain, e-KYC)? (5) How can financial integrity and digital payment innovation be balanced to aid SMEs?

1.2. Research Objectives

The purpose of the current study is to: (1) The purpose of the current study is to: (1) Examine how the requirements of MSB Act regulations impact the adoption of digital payments by MSB-licensed SMEs (2) Determine the main compliance challenges faced by MSB-licensed SMEs, particularly in relation to KYC, CDD, ODD, and suspicious transaction reporting, and assess how non-MSB SMEs may experience indirect compliance-related operational constraints (3) Evaluate how the interplay between regulatory, technological, and organizational factors can be analyzed through the institutional theory, TAM, and DIT; (4) Assess how RegTech solutions (AI, blockchain, e-KYC) can mitigate compliance costs, particularly for resource-constrained MSB-licensed SMEs (5) Present evidence-based policy recommendations to stakeholders that differentiate between directly regulated MSB operators and indirectly affected payment-using SMEs, to balance financial integrity and digital payment innovation.

1.3. Significance of Study

This research has theoretical, practical, and policy implications. In theory, it builds on knowledge by incorporating the institutional theory, TAM, and DIT in its explanation of how regulatory, technological, and social issues interact with digital payment adoption among Malaysian SMEs, with explicit differentiation between MSB-licensed SMEs and non-MSB payment-using SMEs. This multi-theoretical model provides an overall model of the complexities of digital transformation within regulated settings, particularly where regulatory exposure varies across enterprise types.

In practice, the research offers practical recommendations to SME owners and managers in a situation where they face regulatory compliance challenges. The study guides help MSB-licensed SMEs understand their direct AML and CFT obligations under the MSB Act. For non-MSB SMEs, results explain how indirect compliance requirements imposed by regulated financial intermediaries may affect decisions about adopting digital payments. Findings offer recommendations on how to comply with AML/CFT regulations when adopting digital payment systems by identifying barriers and possible solutions offered by RegTech. The results also help payment service providers and technology vendors understand market needs and opportunities for creating compliance-oriented solutions tailored to different types of regulated SMEs.

Further, the research enlightens policymakers, especially BNM, on how to balance the integrity of the financial system and the promotion of innovation. It emphasizes the need for proportionate regulatory approaches that recognize the distinction between directly regulated MSB operators and indirectly affected SMEs. Regulatory frameworks that promote AML/CFT standards at a reasonable cost of compliance to SME may be recommended. This plays a vital role in the milestones of the digital economy and financial inclusion of Malaysia, especially with the support of SMEs, which make up 96.9 percent of enterprises (APEC, 2025).

2. Literature Review

2.1. Malaysia's Money Services Business (MSB) Act and AML/CFT Framework

MSB Act 2011 is a statute governing non-bank financial services such as money changing, remittance, and wholesale currency (Bank Negara Malaysia, 2011, 2024). The Act has an in-depth AML/CFT framework that suggests that MSB operators must obtain BNM licenses and satisfy high standards: customer identification and verification (KYC), CDD to evaluate money laundering risks, Ongoing ODD to monitor transactions continuously, suspicious transactions reporting to the Financial Intelligence Unit, and record keeping for at least 5 years (BNM, 2024).

These are in line with the FATF international requirements (bin Ibrahim, 2017). In 2018, the FATF Mutual Evaluation Report revealed that compliance gaps were present, and the BNM has tried to improve regulatory oversight (Mat Isa et al., 2023). Amendments of the year 2024 also provided strict punishments for violations, as the fines amounted to 10 million RM and jailing to a term of eight to ten years will be imposed (BNM, 2024).

Nevertheless, very strict criteria apply to SMEs that lack resources. The compliance expenses are investments in technologies, training of the staff, outsourcing services, and overhead expenses (Ismail et al., 2023). These costs might make SMEs unwilling to implement digital payments even when they find them advantageous (Kanapathipillai et al., 2024).

2.2. Adoption of Digital Payments by SMEs

Online banking, mobile payments, and e-wallets are examples of digital payment systems that are changing the way SME transactions are processed (Azli and Haron, 2024). The benefits of these systems include better management of cash flow, lower transaction costs, increased customer convenience, increased market reach, and improved financial record-keeping (Rahman et al., 2022). Implementing digital payments is now a more important issue when it comes to the success and survival of SMEs, especially after COVID-19.

Although Malaysia has advantages, its level of SME adoption is lower than that of developed nations (Kanapathipillai et al., 2024). A survey by SAMENTA-Ipsos established 74% of the SMEs are behind in automation and digitalization (The Malaysian Reserve, 2025). Existing obstacles are a lack of financial resources to invest in technology, the lack of digital literacy and technical skills, fears of transaction security and data privacy, intricacies of regulatory compliance, and a lack of financial resources to change to traditional methods (Indiani et al., 2025).

There are high regulatory factors affecting the decisions to adopt. Some AML/CFT requirements can be so strict that SMEs do not adopt digital payment systems due to related compliance costs and complexities (Ismail et al., 2023). Nevertheless, the regulatory frameworks may also support adoption by providing the security of transactions and creating trust among customers (binti Halim and Basu, 2024). The regulatory influence of adoption decisions is important to policymakers and stakeholders of digital financial inclusion.

2.3. Compliance Challenges for SMEs

Under the AML/CFT provisions, SMEs comply with the MSB Act with substantial requirements imposed on them. KYC will require strong customer identity verification systems, which can be expensive and technologically difficult for small businesses (Halim and Basu, 2024). CDD processes mandate that SMEs undertake the process of evaluating and mitigating money laundering risks linked to individual customers, and this entails domain-specific expertise and resources that are most likely out of the reach of SMEs.

ODD necessitates constant monitoring of transactions and regular updates of the customer-related information, which entails advanced monitoring tools and special personnel (BNM, 2024). The report on suspicious transactions compels SMEs to report suspicious transactions, and it might involve the use of training, expertise, and systems to isolate patterns and make such reports. Record keeping requires detailed, documented systems at least five years old, which puts massive storage and data management challenges (Ismail et al., 2023).

Such difficulties are enhanced by the shortage of finances, human resources, and technological impediments. Out of the large number of SMEs, many of them do not have compliance expertise in-house and thus require costly external consultants or lawyers (Tanash, 2025). The compounding impact reduces the adoption of digital payments, and some SMEs then prefer to keep their businesses based on cash transactions so as not to be scrutinized by the authorities, and this eventually reduces the growth potential and competitiveness (Jamil et al., 2023).

2.4. Theoretical Framework: Institutional Theory

The institutional theory describes the process of the reaction of organizations to the external pressures and expectations of the environment (Scott, 2013). There exist three isomorphic pressures, that is, coercive, mimetic, and normative (DiMaggio and Powell, 1983). Coercive pressures are because of formal and informal pressures created by the regulatory bodies and expectations in society. In this respect, the MSB Act is an exercise of coercive power that forces SMEs to use compliant digital payment systems. The penalties and enforcement measures by BNM provide powerful incentives to compliance (Sari et al., 2021). Coercive pressures are used to guarantee minimum standards but can make people comply unwillingly without commitment.

Mimetic pressures are caused when organizations ape successful similar organizations in times of uncertainty. SMEs will consider the introduction of digital payment only once they have seen the success of their industry leaders using these tools, and they will trust only in cases where they can find them presented elsewhere (Siow et al., 2026). Mimetic behavior can fast-track diffusion, but can lead to improper adoption in case circumstances are different. Normative pressures are the result of professionalization and common norms in organizational sectors. Best practices are encouraged by professional associations, industry groups, and educational institutions, so that SMEs are encouraged to use digital payments as the new standard. Normative pressures incorporate voluntary compliance and internalization of values that uphold digital transformation (Scott, 2013). The institutional theory offers a macro-level perspective to view the regulatory and social pressures influencing the SME adoption of digital payment. This must be supplemented, however, by models of technological acceptance that look at both individual and organizational factors.

2.5. Technology Acceptance Model (TAM)

Technology adoption has been explained by the Technology Acceptance Model (TAM) developed by Davis (1989), which assumes the usage of two significant determinants: perceived usefulness (PU) and perceived ease of use (PEOU). PU means the level to which the degree users think that technology will help improve performance, whereas PEOU signifies the level to which the degree users assume that technology will not require any effort (Davis, 1989).

PU in the context of digital payment adoption will be associated with the perceptions of SMEs that the systems will help them to improve their operational efficiency, cut their costs, increase customer satisfaction, and expand business. Research indicates that SMEs that experience a greater PU expectation tend to adopt digital payments (Alshammari and Babu, 2025). Nonetheless, when the perceived benefits are overshadowed by compliance costs, the adoption might be discouraged (Ismail et al., 2023).

PEOU deals with ease of use and the steepness of the learning curve. SMEs that lack technical capabilities can find digital payment systems inaccessible, especially those that have advanced compliance capabilities. Weighted PU is compensated by high PEOU motivation to adopt benefits even in cases of uncertainty. On the other hand, low PEOU prevents adoption, irrespective of usefulness (Jimu and Chimwai, 2025).

TAM has been successfully tested in a variety of situations and technologies, such as mobile banking, e-commerce, and even digital payments (Salimon et al., 2023). TAM in the Malaysian SME background can be seen as a micro-level perspective of comprehending the effects of personal perceptions and attitudes on adoption decisions. Combined with institutional theory, it provides a holistic perspective of factors of adoption.

2.6. Diffusion of Innovation Theory (DIT)

According to the diffusion of innovation theory (Rogers et al., 2014), the diffusion of innovations takes place within a social system over a period. Five innovation characteristics affect the adoption rates: relative advantage, compatibility, complexity, trialability, and observability. Relative advantage is the extent to which an innovation is perceived as superior to the previous one. To SMEs, the benefits of using digital payment systems are that they are quick, cheaper, have better record management, and have access to larger market bases. The larger the perceived advantage, the higher the adoption chances (Indiani et al., 2025).
Compatibility is in terms of being consistent with the values, experiences, and needs of adopters. The digital payment systems that can be implemented in the existing business processes and customer expectations are adopted more easily. Lack of compatibility with the traditional practices or customer preferences may become an obstacle (Timur et al., 2025). The concept of complexity means that it appears to be hard to grasp and implement innovation. It has high complexity, especially when it comes to compliance features, which may put off SMEs who may not be technical. Easy-to-understand systems that are simplified and have specific instructions are more likely to be adopted (Salimon et al., 2023).
Trialability enables potential adopters to experiment on a scaled-down scale before full investment. Digital payment services that provide a trial period, pilot program can minimize the adoption risk and create confidence. Observability is the visibility of the outcome of innovation. Evidential advantages motivate purchase by social influence and word of mouth (Rogers et al., 2014). DIT is a middle-level model between a macro-level view of institutional theory and a micro-level view of TAM. Digital payment systems can be developed and predominantly popularized to make it easier to adopt SMEs by analyzing the nature of innovation and diffusion processes to that effect, which DIT will provide.

2.7. Regulatory Technology (RegTech) Solutions

Regulatory Technology (RegTech) is a type of technology application used to make regulatory compliance more efficient and cost-effective (Rafiq and Sohail, 2025). RegTech applications are especially applicable in the case of SMEs with high AML/CFT demands but without the resources to pursue traditional compliance technologies. The notable RegTech solutions are AI, blockchain, and e-KYC. Using AI, automated pattern recognition, transaction monitoring, and the possible detection of anomalies are also useful in causing suspicious activity to be detected more effectively than through manual approaches (Lokanan, 2025). The volume of transactions that are analyzed in real-time by AI-powered systems can make for more accurate flagging of possible money laundering or terrorism financing. This will decrease the cost of compliance and improve effectiveness (Kothandapani, 2025). The use of AI can be applied to customer risk assessment, automatic reporting, and monitoring of regulatory changes, which will allow for active compliance management (OECD, 2025).

The blockchain technology has decentralized and tamper-proof records of transactions, thereby increasing transparency and auditability (Khan et al., 2026). KYC systems based on blockchain enable the sharing of customer information among financial institutions, and this reduces repetitive verification methods. Smart contracts mechanize regulatory activities such as transaction and reporting thresholds to provide standardization in the application of rules (Luna et al., 2024). Electronic KYC (e-KYC) solutions enable simplifying the customer identification and verification using a digital identity verification system, a biometrics authentication system, and an automated document verification system (Moodys, 2023). E-KYC can save onboarding time and costs of customers by more than 40 percent and increase accuracy and security. It will be integrated with government databases and digital identity platforms to ensure a smooth verification and enhance the experience of the customer without breaching regulations (binti Halim and Basu, 2024).

The adoption of RegTech among SMEs has not been much because of the initial costs of investment, technical sophistication, and privacy of the information, and integration complications by the company with the existing system (Rafiq and Sohail, 2025). Nevertheless, with the regtech solutions becoming more affordable and accessible, it is possible to apply promising opportunities to SMEs to break the compliance barriers and implement digital payment systems without any hesitation.

3. Methodology

3.1. Research Design

This study employs a structured literature review methodology to examine the relationship between regulatory compliance and the adoption of digital payments among Malaysian SMEs. The review synthesizes literature concerning the MSB Act, AML/CFT compliance mandates, digital payment systems, and RegTech, employing institutional theory, the TAM, and the DIT as analytical frameworks. To enhance methodological rigor and transparency, the study adhered to a PRISMA 2020-inspired screening framework for the systematic identification, screening, eligibility assessment, and inclusion of pertinent sources (Page et al., 2021). The study isn't a full systematic review with meta-analysis, but structured procedures were used to reduce selection bias and make the study easier to replicate.

3.2. Data Sources and Databases

Literature was retrieved from the following academic databases:

- Scopus
- Web of Science

- Google Scholar

In addition, official institutional sources were consulted, including:

- Bank Negara Malaysia (BNM)
- Financial Action Task Force (FATF)
- OECD
- SME Corporation Malaysia

The search period primarily comprised publications from 2019 to 2025, which is when digitalization and regulatory changes happened after COVID-19. Seminal theoretical works (Davis, 1989; DiMaggio and Powell, 1983; Rogers et al., 2014) were included regardless of publication year since they are important to the discipline.

3.3. Search Strategy and Keywords

Boolean search combinations were used to perform research more accurately. A sample search string is: ("Money Services Business Act" OR "MSB Act Malaysia") AND ("SME" OR "small and medium enterprise") AND ("digital payment" OR "e-payment" OR "cashless") AND ("AML" OR "CFT" OR "KYC" OR "CDD" OR "ODD" OR "RegTech"). We used more combinations to find studies on digital adoption, compliance costs, and comparisons between ASEAN countries.

3.4. PRISMA-Based Screening and Selection Process

The identification and screening process followed four stages: identification, screening, eligibility, and inclusion.

Identification

The initial search yielded:

- Scopus: 94 records
- Web of Science: 51 records
- Google Scholar: 112 records
- Regulatory and institutional sources: 27 records

Total records identified: 284

After removing duplicate entries (n = 46), 238 records remained for screening.

3.5. Screening

The 238 records were screened based on title and abstract.

A total of 142 records were excluded due to:

- Irrelevance to the Malaysian context
- Absence of SME focus
- No linkage to AML/CFT or digital payment adoption

Records retained for full-text assessment: 96

3.6. Eligibility

A full-text review was conducted on 96 articles. A total of 44 articles were excluded at this stage for the following reasons:

- Not focused on Malaysia (n = 24)
- Insufficient methodological transparency (n = 11)
- Conceptual discussion without regulatory or empirical relevance (n = 9)

3.7. Included Studies

The final qualitative synthesis included 52 sources, comprising:

- 38 empirical journal articles
- 9 regulatory and policy documents
- 5 foundational theoretical works

The full screening process is illustrated in Figure 1 (PRISMA Flow Diagram).

3.7.1. Inclusion Criteria

Studies were included if they:

- Focused on Malaysian SMEs or financial regulation
- Examined AML/CFT compliance or MSB Act implications
- Addressed digital payment adoption or RegTech
- Provided empirical evidence or theoretically grounded analysis
- Were published in peer-reviewed journals or issued by authoritative regulatory bodies

3.7.2. Exclusion Criteria

Studies were excluded if they:

- Duplicates
- Lacked methodological transparency
- Were opinion-based without analytical rigor
- Had no relevance to SMEs or regulatory compliance

3.7.3. Critical Appraisal of Sources

To enhance analytical robustness, the included empirical studies were assessed based on:

- Clarity of research design
- Sample adequacy
- Statistical or qualitative rigor
- Relevance to the Malaysian regulatory context

Regulatory documents were evaluated based on legal authority, institutional credibility, and policy relevance (e.g., BNM, FATF, OECD).

This appraisal process ensured that only methodologically credible and contextually relevant sources informed the synthesis.

3.7.4. Analytical Framework

The selected studies were synthesized thematically across five domains:

1. Direct compliance obligations affecting MSB-licensed SMEs
2. Indirect regulatory effects on non-MSB SMEs
3. Digital payment adoption determinants (TAM constructs)
4. Innovation diffusion characteristics (DIT attributes)
5. Institutional pressures (coercive, mimetic, normative)

This structured synthesis enables an integrated analysis of regulatory and technological dynamics in the Malaysian SME environment without overstating methodological uniqueness.

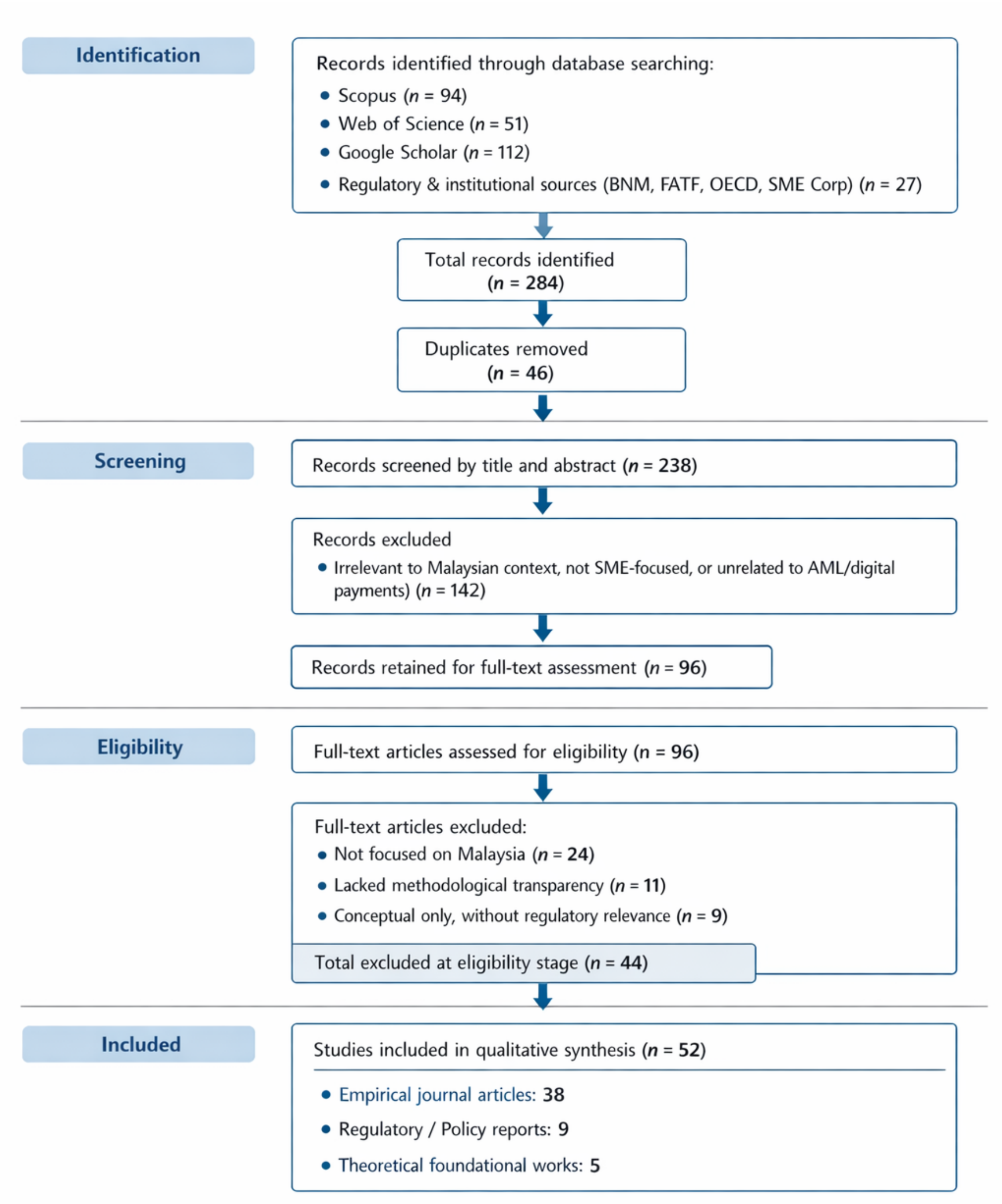

Figure 1: PRISMA flow diagram

4. Findings and Discussion

According to the literature review, the use of digital payment systems by Malaysian SMEs is significantly challenged because of the high compliance levels with the MSB Act. These impediments are caused by interrelated issues, including resource shortages, regulatory constraints, technical limitations, and organizational capacity. According to Bank Negara Malaysia, over 90% of businesses in Malaysia now accept at least one form of cashless payment, especially in the retail and food services sectors. This is a big change since COVID. However, adoption rates differ by sector. For example, micro-enterprises and traditional service sectors have lower digital penetration than retail and hospitality sectors.

4.1. Reciprocation of Particular Compliance Requirements.

The MSB Act has unique challenges for SMEs with each compliance requirement. KYC regulations require the requirement to deploy strong systems of customer identification and verification. This is through the gathering and authentication of customer data such as identity documents, address proofs, and business documentation. Surveys in Malaysia show that smaller financial service providers may have compliance-related administrative costs that are between 3% and 8% of their annual operating expenses. Micro-enterprises, on the other hand, have higher per-unit compliance costs because they don't have economies of scale. For SMEs with a small administrative staff, following and enforcing good KYC procedures may be expensive and take a long time (Halim and Basu, 2024). In addition to basic identification, CDD also includes risk assessment and monitoring. SMEs need to look at risk profiles based on how they do business, where they do business, and who they do business with, PEPs. Qualitative interviews with SME operators in Malaysia show that many of them employ outside compliance consultants since they don't have the skills in-house. This raises their operating costs. More licensed financial intermediaries use this outsourcing model than SME businesses that only use it for payments. ODD is a constant operational burden because it requires monitoring transactions and updating risks regularly. For MSB-licensed businesses, automated monitoring systems can be very expensive to set up, which makes it more challenging for smaller businesses to get started than for larger licensed businesses. There is also a legal risk involved in reporting suspicious transactions. However, evidence from ASEAN countries shows that places like Singapore have clearer rules for compliance and regulatory sandboxes, which may make things less confusing than Malaysia's enforcement-driven view among SME businesses.

4.2. Regulatory Burdens and Compliance Challenges

SMEs that operate digital payment systems have to follow a lot of rules under the MSB Act. Recent data from Malaysian regulators show that actions against unlicensed operators increased after the 2024 changes. This added to the pressure on institutions to act. This may make smaller operators feel like they are at risk of being regulated, even though it makes financial integrity stronger. These needs include costs like investing in technology infrastructure, training employees, employing outside consultants, and paying for administrative overhead. In comparison, ASEAN economies like Indonesia and Thailand have sped up the standardisation of QR codes (for example, QRIS in Indonesia and PromptPay in Thailand). This has made it cheaper for micro-enterprises to get started and has encouraged more small and medium-sized businesses to join digital ecosystems. Malaysia's DuitNow QR program also made things easier to get to, but it still costs licensed MSB operators more to follow the rules than it does for regular SMEs that accept payments. The MSB Act puts pressure on institutions to comply with institutional theory. However, opposing evidence suggests that regulatory clarity can also bolster trust in digital payments, thereby augmenting consumer confidence and promoting SME engagement. Research conducted within ASEAN contexts indicates that robust AML/CFT frameworks can promote the long-term sustainability of the digital ecosystem rather than hinder its adoption.

4.3. Influencing Factors of Digital Payments Adoption

According to Malaysian data, SMEs in the retail, food and beverage, and tourism sectors report higher perceived usefulness for e-wallets and QR payments because of the high volume of transactions and customer demand. On the other hand, SMEs in low-frequency B2B sectors are more careful about adopting these technologies. When costs of compliance are higher than perceived operational gains, perceived usefulness may go down. Some Malaysian SMEs assert that switching to digital payments made it easier to get formal financing and made cash flow clearer. This helps to offset some of the costs of compliance. This means that following the rules and going digital may have long-term benefits that work together. Comparing countries shows that Singapore's easier e-KYC onboarding processes make things easier for SMEs, while Malaysian SMEs say that following documentation rules is moderately difficult. Evidence from Indonesia's swift digital onboarding of SMEs post-QRIS implementation indicates that trialability and observable peer adoption markedly enhance uptake. Malaysia has similar mimetic effects in urban SME clusters, but they spread less quickly in rural areas. Normative pressures from Malaysian industry associations and digitalisation grants (e.g., SME digitalisation initiatives) positively influence adoption, indicating that regulatory pressure is not the exclusive factor influencing SME behaviour.

4.3. Role of RegTech Solutions

AI-based transaction monitoring and anomaly detection cut down on the amount of work that needs to be done by hand (Lokanan, 2025). Blockchain provides more accurate records (Khan et al., 2026). E-KYC programs cut down on the time it takes to get new employees (Moody's, 2023). In Malaysia, SMEs are still just starting to use RegTech. Larger licensed operators are more likely to use AI-based monitoring systems than micro-enterprises. This uneven adoption shows that SMEs don't have the same number of resources. Singapore's RegTech ecosystem is better because fintech and regulators work together better. Malaysia's ecosystem is growing, but it's still mostly in higher institutions. Counterevidence suggests that SMEs find it easier to understand and trust compliance when RegTech solutions are included in payment platforms. This suggests that integrated compliance design may help businesses avoid regulatory fatigue. Malaysian programs show that organised digital literacy workshops make SMEs more ready to use payment systems that help them follow the rules, especially for very small businesses.

4.4. Theoretical Implications

The combination of institutional theory, TAM, and DIT offers an all-inclusive framework of the understanding of the intricate interaction of regulatory, technological, and social opportunities affecting SMEs in adopting digital payments. Institutional theory describes the macro-level regulatory forces that influence the expansion of the adoption setting, TAM describes micro-level personal perspectives and attitudes that result in adoption choices, and DIT investigates meso-level features of innovation and diffusion mechanisms that promote or end adoption.

This multi-theoretical framework shows that the adoption of digital payments is not predetermined only by regulatory demands or technology but is based on the dynamics between institutional factors, user attitudes, and features of innovations. The interventions in policy should be made to be effective on all levels, which should include provision of proportionate regulation structures, encouragement of user-friendly technologies and supportive social contexts that are provided by industry networks and professional associations.

The research expands upon the literature that is on the adoption of technology, with its application to the specific case of the controlled financial services in an emerging economy. It shows that compliance with regulations can not only be an obstacle but also a facilitator in case adequate support structures and technologies are available. This subtle insight is part of more general arguments concerning the importance of striking the proper balance between financial integrity and innovation in digital financial services (Davis, 1989; Rogers et al., 2014; Scott, 2013).

5. Policy Recommendations

According to the findings, several policy suggestions are set out to stakeholders such as the regulatory agencies, Bank Negara Malaysia, SMEs, payment service providers, and technology vendors.

5.1. Suggestions towards Regulatory Bodies and Bank Negara Malaysia.

Regulatory authorities should also develop risk-based responses to AML/ CFT compliance, where appropriate regulations can therefore be more amenable to SMEs with appropriate size, transacting volume, and risk profile. This lessens pressure on the less risky SMEs, but there are standards for more risky organizations (binti Halim and Basu, 2024). Streamlined compliance procedures of the SMEs such as simplified KYC and less documentation, can reduce these barriers without undermining effectiveness.

BNM needs to offer clear guidance and assistance to the SMEs by way of detailed manuals, online help, and help desks on the compliance requirements and best practices. Capabilities and awareness may be improved through workshops and training (Jamil et al., 2023). Cost barriers can be reduced by using financial incentives like grants, subsidies or tax breaks on investments made in RegTech. Experimentation and learning can be achieved through regulatory sandboxes where innovative compliance solutions can be tested with some level of control (OECD, 2025).

A multi-stakeholder consultation with SMEs, payment service providers, technology vendors, and industry associations in policy formulation will make the regulations viable, reasonable, and conducive to innovation (Isa et al., 2023). Frequent consultations and feedback systems allow a responsive regulation that would depend on the changing technological and business environment.

5.2. Recommendations for SMEs

The participants that can be used by SMEs include training and capacity building to increase knowledge among the owners and the staff about regulatory requirements and digital technologies. Confidence and competence can be formed through the use of training programs that include CFAT/ML, digital payment systems, and RegTech solutions (Ismail et al., 2023). The partnership with technology providers and consultants might help offer customized solutions and continuation, especially to users who lack in-house capabilities.

Membership in industry associations and networks creates an opportunity to learn with peers, best practices, as well as jointly lobbying for policies. Networking will help gain access to resources, information, and peer support that can help overcome the complexities of the digital transformation (Siow et al., 2026). Incremental strategies should be considered by SMEs and should use simple systems that can be upgraded over time with superior features as the capacity becomes available. This reduces interference and allocation of expenditure in the long run. Financial burdens can be lessened by taking advantage of government support and incentives to go digital and to comply: grants and subsidies. SMEs are advised to pursue and exploit the available support systems in order to adopt (Tanash, 2025).

5.3. Suggestions in relation to Payments Service Providers and Technology Vendors.

Technology vendors and payment service providers ought to come up with easy-going and cost-effective solutions based on SME requirements. The systems must have user-friendly interfaces, effective guidelines, and support services that allow SMEs to use them easily without having to possess massive technical knowledge. It should integrate well with the currently available business systems without disrupting the business and without increasing the complexity of the implementation.

Solutions made available to different budget SMEs should have flexible pricing schemes, such as tiered pricing, pay-as-you-go, and subscription-based schemes. Adoption risk can be minimized through trial periods and pilot programs, and confidence is formed (Rogers et al., 2014). Customer satisfaction and retention can be increased with the help of training and support services, such as onboarding services, constant technical assistance, and educational material.

Such cooperation with regulatory bodies makes sure whether solutions are compliant or not and satisfy the regulatory expectations. Closely collaborating with BNM and other regulators assists the providers to be aware of the changes in regulations and modify their offerings to suit those changes (Rafiq and Sohail, 2025). Being part of industry forums and working groups helps in policy formulation in favor of the development of the digital payment ecosystem.

5.4. Industry Association and Professional Networking Recommendations

Associations and professional networks in the industry ought to encourage the best practices and standards in adopting digital payments and complying with AML/CFT. Guidelines, toolkits, and case study development and dissemination may be useful to give practical information and motivation to the SMEs (Scott, 2014). The programs of certification of compliance competence can strengthen the level of professionalism and inspire confidence.

Conducting workshops, conferences, and networking would help to enable knowledge sharing and collaboration among SMEs, service providers, and the regulators. Such platforms can make stakeholders talk and exchange problems, build relationships, and support digital transformation (Siow et al., 2026). Having supportive policies that will be useful in the policy discussions on behalf of the SMEs will maintain practical and proportional regulations. The interactions with BNM and other professionals may affect the regulatory structures between the financial integrity and innovation requirements (Isa et al., 2023).

6. Conclusion

This review literature has explored the multifaceted dynamics of the effect of regulatory compliance on the use of digital payments between Malaysian SMEs in the context of the MSB Act. The results show that although the Act incorporates the requirements needed to make AML/CFT compliance, there are strict standards that give a competitive advantage to resource-limited SMEs. Quantitative responsibilities such as KYC, CDD, ODD and suspicious transactions reporting are costly and highly difficult, which could turn off the uptake of digital payment systems.

The paper has established that regulatory compliance is no longer a financial cost issue, but also involves capacity constraints and lack of technical expertise in an organization and operational interferences. SMEs with lean profit margins and resource strips find it especially difficult, to set up funds towards compliance infrastructure, the training of staff and continuous monitoring systems. These issues are increased by the constantly developing regulatory environment, in which the amendments to the MSB Act are forcing one to constantly adapt to the changes and invest in the new compliance processes. Although the 2024 amendments are essential towards empowering the AML/CFT regime in Malaysia, they have heightened pressure on the already challenging compliance burden on SMEs (Bank Negara Malaysia, 2024).

Coupling institutional theory, TAM, and DIT, one gains a wholesome insight of the determinants of adoption decision. The institutional environment is developed because of coercive pressures through the MSB Act and the influence of mimetic and normative pressures by peers in the industry and professional networks. Individual adoption can depend on the perceived usefulness and ease of use, and diffusion rates can depend on the characteristics of innovation like relative advantage, compatibility, and complexity. It is a multi-theoretical framework to note that efficient interventions should be based on regulatory, technological, and social aspects, rather than being independently addressed.

The framework portrays that the successful adoption of digital payments depends on the harmonization at different levels of analysis. On the institutional level, the regulatory framework ought to be set in such a way that it will facilitate the fulfillment of the financial integrity goals alongside the promotion of innovation and development of SMEs. At the organizational scale, SMEs should be provided with sufficient resources, capabilities, and support systems to adopt and sustain digital payment systems in an effective manner. At the personal level, owners and employees of companies should have the right knowledge, skills, and attitudes toward digital technologies and compliance standards. Any form of misalignment at a level may result in blockers to adoption, even where there are optimistic environments in other levels (Davis, 1989; Rogers et al., 2014; Scott, 2013). RegTech solutions can include AI, blockchain, and e-KYC systems, which represent some promising opportunities that SMEs can access when it comes to eliminating compliance barriers. These technologies can automate compliance activities, cut costs, and maximize effectiveness. It is possible to process a vast number of transactions with AI-powered systems more effectively than through manual systems, discovering suspicious patterns more effectively and quickly. The blockchain network offers reliable, transparent, and irrefutable records of any transactions and offers high auditability to the regulators, as well as minimizes the role of administration. E-KYC systems enable the onboarding of new customers more quickly, cheaply, and more easily (Khan et al., 2026; Lokanan, 2025).

Nevertheless, the adoption is still low because of financial, technical, and organizational reasons. The start-up costs of RegTech applications may be quite costly to smaller SMEs, although the long-term savings may be well-suited to cover the cost. Technical complexities involve house skills or outsourcing, which involve extra expenditure. Interoperability with the existing systems may also be complicated, especially in cases involving SMEs with legacy technology or mismatched systems. The absence of data privacy and security is also an obstacle, as SMEs need some assurance to implement the cloud-based system or provide sensitive customer data via RegTech solutions (Rafiq and Sohail, 2025).

It would be a joint effort by policymakers, providers of technology, and industry players to overcome these barriers. Financial barriers can be minimized by government intervention in the form of subsidies, grants, and tax incentives to encourage early adoption. Regulatory sandboxes can offer secure conditions in which new compliance solutions can be tested without the fear of punishment in case of an experiment failure. The technology providers have to come up with solutions that are highly specific to the needs of the SMEs, focusing on lower costs and ease of use as well as integration. Knowledge sharing, peer learning, and advocacy of supportive policies can be done through industry associations (OECD, 2025).

The recommendations on policy priorities include risk-based regulation, streamlined compliance, financial incentives, capacity building, and stakeholder collaboration. Through these suggestions, Malaysia will be able to establish an encouraging implementation environment of digital payments in the SMEs without losing the integrity of the financial system. This is an essential balance to pursue the objective of a digital economy and competitiveness of SMEs in an environment that is becoming increasingly digital on a global scale. Digital transformation is rapidly spreading to industries due to the COVID-19 pandemic, and having the option of conducting payments digitally has become crucial to business survival and expansion. Companies that successfully cross the digital payment divide put themselves in a favorable position to take the opportunity in the future, whereas those who remain behind may find themselves pushed to the periphery by the changing markets (Ahmad et al., 2022).

The results of this research can be applied in other countries that are becoming emerging economies due to similar problems in focusing on financial integrity and digital innovation. Most developing nations are enhancing their AML/CFT infrastructure in line with global requirements and pressure from bodies as FATF. With the increased measures of regulation in these countries, they will probably face the same struggles between regulation requirements and the development of SMEs. The experience of Malaysia could be used to inform the policy development in similar settings due to its multi-theoretical analytical framework and detailed policy recommendations (Isa et al., 2023).

Empirical studies of certain regulatory provision effects, the efficacy of technology solutions, and intervention effects should be implemented in future research. The longitudinal studies that monitor the dynamic patterns of adoption and their compliance over the course of time can offer useful information about the dynamic processes and the long-term consequences. Comparative analysis with other countries, which struggle with similar issues, can help to find out the best practices and the lessons gained, which can become a contribution to the world in terms of financial integrity and innovation reconciliation. Quantitative analyses may be supplemented by qualitative studies on the views and experiences of SME owners and how they make decisions, as this will offer deeper insights into the obstacles to adoption and in its facilitation.

After all, financial integrity and digital innovation should be pursued together by all professional stakeholders to realize their dual goals. Regulators have to come up with proportional and risk-based structures that safeguard the financial systems, without stifling innovation. SMEs will have to invest in the development of their digital capabilities and compliance capacities by means of the support and resources at their disposal. Technology providers need to establish easy-to-access and cheap solutions that benefit the SME real needs. Associations in industries should help in sharing knowledge and acting collectively. By using a well-coordinated approach based on evidence-based policy and assisted by relevant technologies, it may help Malaysia develop a powerful, inclusive digital payment system that will fulfill the interests of all stakeholders without undermining the highest standards of financial integrity.

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