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SME Development in Malaysia: Domestic and Global Challenges

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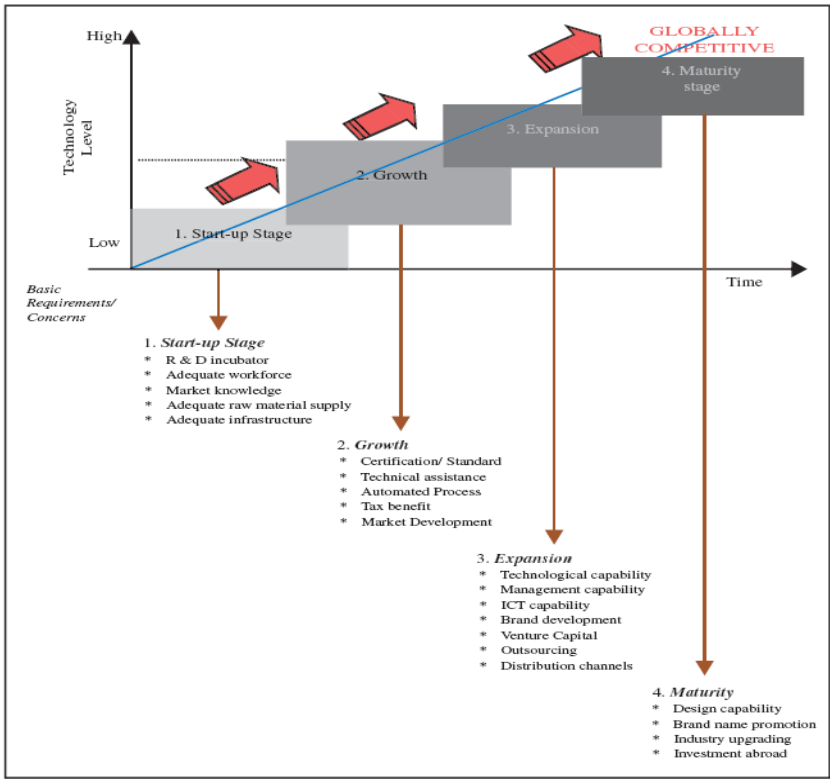
1 INTRODUCTION

SMEs in Malaysia play an important role in the country's economic development. According to statistics provided by SMIDEC (2004), SMEs accounted for 89.3 per cent of all establishments in the manufacturing sector in the year 2000. They contributed 29.1 per cent of total manufacturing output, 26.1 per cent to value-added, 27, and 32.5 per cent of employment in 2003. In addition, value added production from SMEs is expected to be worth RM120 billion or 50 per cent of total production in the manufacturing sector by 2020. However, the share of SMEs in total exports in Malaysia is only around 20 per cent, lower than many other countries such as the Philippines, Hong Kong, Taiwan and even the USA (SMIDEC, 2002). The largest concentration, by number, of SMEs in Malaysia is in the textile and apparel sector, food and beverages, metals and metals products and wood and wood products. The majority of manufacturing companies in Malaysia are located in the central part of Malaysia and around the country's major industrial regions.

The government's commitment and concern for the development of SMEs was made evident from the early 1970s with the introduction of the New Economic Policy in 1971, which aimed to improve people's welfare and restructure ethnic economic imbalances. Furthermore, the government's commitment to the development of SMEs can also be seen in the second Industrial Master Plan (IMP2), which will end in 2005, followed by the Third Industrial Master Plan (IMP3), from 2006-2020, coinciding with the country's vision for 2020 (MITI, 2005). For example, the government has implemented numerous policies and strategies under this plan which was

formulated to enhance the growth of the manufacturing sector through the entire value chain and to encourage cluster-based industrial development. Hence, this plan provides an integrated approach to the development of industrial areas and opportunities for the growth of SMEs (MITI, 2005). Figure 1 shows the phases of development of all enterprises in Malaysia.

Figure 1: Phases of Enterprise Development (4 Stages)



Source: SMIDEC (2002)

It is recognized, however, that SMEs in many countries face severe and numerous challenges. At the theoretical level prior studies have identified some of the barriers facing SMEs (for example Wan, 2003; Stuti, 2005; Moha, 1999; Hall, 2002; and SMIDEC, 2002). Wan (2003), for example, highlighted the many challenges facing SMEs in a globalized environment, including, for example, lack of financing, low productivity, lack of managerial capabilities, access to management and technology, and a heavy regulatory burden. In the Malaysian context SMEs face many similar challenges, which have been

highlighted by APEC survey (1994), SMI development Plan, 2001-2005 (SMIDEC, 2002), Ting (2004), UPS survey (2005) and others. For example, among the major challenges included: lack of access to loans; limited adoption of technology; lack of human resources; and competition from MNCs and globalization.

Hence, the primary objectives of this study are to analyze and discuss the development of Malaysian SMEs and their role, as well as various contributions, in the national economy. The chapter goes further by reviewing extant literature to identify the major challenges facing this sector in Malaysia as well as government policies aimed at the development of SMEs. In doing so the chapter proceeds as follows. Section 2 presents a profile of Malaysian SMEs, their role and contribution in different sectors and in the overall national economy. This section will also shed some light on their characteristics, especially in the manufacturing sector. Section 3 reviews the existing literature, including the empirical literature, in regard to the challenges that are facing Malaysian SMEs. Government policies as well as programs are analyzed and discussed in section 4. Finally, major conclusions and some policy recommendations will be reported in section 5.

2 A PROFILE OF SMEs IN MALAYSIA

SMEs in Malaysia have been defined according to size, turnover and activity. Definitions of SMEs in Malaysia fall into 2 broad categories:

1. Manufacturing, manufacturing-related services and agro-based industries
    - Full-time employees not exceeding 150; OR
    - Annual sales turnover not exceeding RM25 million

2. Services, primary agriculture and Information and Communications Technology (ICT)
    - Full-time employees not exceeding 50; OR
    - Annual sales turnover not exceeding RM5 million

An enterprise is considered to be an SME based on annual sales turnover or number of full-time employees as indicated in Table 1.

In terms of the total number of SMEs in the country, the 2000 census, which was conducted by the Department of Statistics, showed there was a total of 20,455 active establishments in the manufacturing sector, out of the 44,185 manufacturing companies registered with the Companies Commission of Malaysia (CCM) as shown in Table 2. Out of which 18,271 or 89.3 per cent were SMEs. The textiles and apparel sector accounted for around 17 per cent

of the total, making it the largest, followed by food and beverages with more than 14 per cent, metals and metals products (14.3 per cent) and wood and wood products accounted for 13.6 per cent. The 2000 census also captured a total of 192,527 establishments in the services sector, of which 96.8 per cent were SMEs. Most of the companies in the services sector (88 per cent) were in retail and wholesale, followed by education and health (4.4 per cent), professional services (2.9 per cent) and transport and communication (2 per cent).

Table 1 Definition of SMEs in Malaysia

	Category	Micro-enterprises	Small enterprises	Medium enterprises
1.	Manufacturing, Manufacturing-related services and Agro-based industries	Sales turnover of less than RM250,000 OR full-time employees less than 5.	Sales turnover between RM250,000 and RM10 million OR full-time employees between 5 to 50.	Sales turnover between RM10 million and RM25 million OR full-time employees between 51 and 150.
2.	Services, Primary Agriculture and Information and Communication Technology (ICT)	Sales turnover of less than RM200,000 OR full-time employees less than 5.	Sales turnover between RM200,000 and RM1 million OR full-time employees between 5 and 19.	Sales turnover between RM1 million and RM5 million OR full-time employees between 20 and 50.

Source: SMIDEC

Table 2 Distribution of SMEs by Size in 2000

Type	Number of Establishments	Share (%)
Micro	7,171	39.3
Small	9,445	51.7
Medium	1,655	9.1
Total SMEs	18,271	89.3
Large	2,184	10.7
Total enterprises	20,455	100.0

Source: Department of Statistics, Census 2000

As shown in Table 3 the largest concentration of SMEs is in the textile and apparel sector (18.2 per cent), followed by food and beverages (15.2 per cent),

metals and metal products (14.8 per cent) and wood and wood products (14.1 per cent).

In terms of geographical location, the majority of manufacturing companies in Malaysia are located in the central parts of the country and around the country's major industrial regions. Johor has the largest concentration of manufacturing companies with 17.5 per cent, followed by Selangor (16.7 per cent), Perak (9.4 per cent) and Palau Pinang (8.7 per cent). SMEs in Selangor are predominantly in the transport equipment and electrical sectors, while in Johor there is a large concentration in the textiles and apparel and wood-based sectors. The majority of other sectors, such as food and food related manufactures, are concentrated in the states of Perak and Johor.

Table 3 Distribution of SMEs in the Manufacturing Sector (by Sector) in 2000

Sector	Number of establishments	SMEs	Percentage of SMEs (%)
Textiles & Apparel	3,419	3,319	18.2
Food & Beverages	2,949	2,749	15.2
Metal & Metal Products	2,918	2,709	14.8
Wood & Wood Products	2,776	2,582	14.1
Paper, Printing, Publishing	1,288	1,195	6.5
Machinery & Engineering	1,249	1,135	6.2
Plastics Products	1,121	988	5.4
Electrical & Electronics	907	543	3.0
Non Metallic Mineral Products	893	803	4.4
Other (Jewellery)	733	666	3.6
Petro-Chemical & Chemical	712	526	2.9
Transport Equipment	507	433	2.4
Rubber & Rubber Products	482	366	2.0
Palm Oil & Palm Oil Products	434	155	0.8
Leather	67	65	0.4
Total	**20,455**	**18,271**	**100.0**

Source: SMIDEC (2004)

SME sectors in Malaysia

As discussed earlier, SMEs in Malaysia account for a large proportion of the total number of businesses in many sectors, and contribute a considerable share in terms of GDP. As in many other countries SMEs in Malaysia are involved in various industries. In determining the importance of SMEs in the country, especially in terms of their economic contribution, it is important to

classify or categorize them. Hence, we now examine manufacturing and service SMEs.

SMEs in the Manufacturing sector

SMEs in the manufacturing sector are involved in activities such as the processing and production of raw materials including food, beverages, textiles, petroleum, wood, rubber, and the assembly and manufacturing of electrical and electronics appliances and components, among others (Table 3). SMEs account for more than 90 per cent of the total number of manufacturing establishments in the country. According to statistics provided by SMIDEC (2004), SMEs contributed 29.1 per cent of total manufacturing output, 26.1 of value-added and 32.5 per cent of employment in 2003. As indicated by Table 4 the output of SMEs grew by 9.7 per cent during 2002-03, value added expanded by 11.8 per cent and employment by 3.7 per cent, due to improved labour productivity. Table 4 also indicates that the share of employment by SMEs expanded from 31.5 per cent in 2002 to 32.5 per cent in 2003 due to growth in employment of 3.7 per cent in 2003.

Table 4 Contribution of SMEs in the Manufacturing Sector (2002-2003)

Indicators	**Value**		**Share of Manufacturing Sector output (%)**		**Annual Growth (%)**
	2003	2002	2003	2002	2003
Total Output (RM billion)	68.9	62.8	29.1	29.1	9.7
Added Value (RM billion)	14.2	12.7	26.1	25.8	11.8
Employment	375,840	362,345	32.5	31.5	3.7

Source: National Productivity Corporation

As shown in Table 5 the increase in labour cost per employee of 7.3 per cent, closely matches the increase in value-added per employee of 7.8 per cent, implying a tight labour market. Therefore, to further improve SME competitiveness a reduction in unit labour cost is required.

Table 5 Labour and Capital Productivity of SMEs in 2003

Labour Productivity	Value	Growth
Output per Employee (RM)	183,222	5.6
Added Value per Employee (RM)	37,675	7.8
Labour Cost per Employee (RM)	18,762	7.3
Added Value per Labour Cost (Pure Number)	2.0	0.4
Unit Labour Cost (Pure Number)	0.1	1.6
Capital Productivity		
Fixed Assets per Employee (RM)	35,792	4.0
Added Value per Fixed Asset (Pure Number)	1.1	3.6

Source: National Productivity Corporation

Table 6 Contribution to Output, Growth in Output, Contribution to Value-added and Growth in Value-added by SMEs in the Manufacturing Sector in 2003

Segment	Contribution to Output (%)	Growth in Output (%)	Contribution to Value-added (%)	Growth in Value-added (%)
Food & Beverages	30.6	9.1	19.8	16.3
Wood & Wood Products	8.3	11.5[1]	9.6	16.3[2]
Rubber & Plastic Products	10.8	8.8	12.2	13.3
Machinery & Equipments	2.9	8.9	4.2	11.3
Transportation	2.5	-2.3	3.3	-0.5
Textiles & Apparel	2.2	1.2[3]	3.2	4.7[4]
Chemical & Chemical Products	11.9	10.6	12.6	16.3
Metal & Metal Products	13.6	-	13.9	-
Electrical & Electronics (E&E)	5.2	-	5.1	-
Non Metallic Mineral Products	4.8	10.5	6.6	13.7

Source: National Productivity Corporation

Notes:

1. Inclusive of growth in both Furniture (6.3 per cent growth) and Wood and Wood Products (5.2 per cent growth).
2. Inclusive of growth in both Furniture (8 per cent growth) and Wood and Wood Products (8.3 per cent growth).
3. Growth in Apparel was 2 per cent while Textiles had a -0.8 per cent decline. Total growth was 1.2 per cent for 'Textiles & Apparel'.
4. Growth in Apparel was 3.5 per cent while growth in Textiles was 1.2 per cent. Total growth was 4.7 per cent for 'Textiles & Apparel'.

However, in terms of overall SME performance in the manufacturing sector, according to statistics provided by the National Productivity Corporation in

2003, this sector performed well in all the key economic indicators. Table 6 shows the contribution of this sector to output and value-added as well as their growth.

Moreover, Table 6 shows that SMEs in the food and beverages sector contributed the highest output (30.6 per cent) followed by Metal and Metal products (13.6 per cent), and then chemical and chemical products (11.9 per cent). In addition, the Electrical & Electronics sector contributed 23.1 per cent of total manufacturing output but only 5.2 per cent of this was contributed to by SMEs, indicating the dominance of multinational corporations (MNCs) in the industry. The decline in output of motor vehicles and transportation was due to the anticipation of tariff reductions as a result of the ASEAN Free Trade Agreement (AFTA). Consumers withheld purchases because of uncertainty and this affected SMEs supplying parts and components.

As can been seen from Table 7 the food and beverages sector has the highest SME share of employment (16.6 per cent) as a result of low barriers to entry. SMEs have become increasingly aware of opportunities in the convenience and 'halal' food market and strong growth in the sector reflects this trend. This is having a positive impact on capacity expansion and technological upgrading. The Wood and Wood products sector has the second highest rate of participation (16.2 per cent) followed by Rubber and Plastic Products (13.1). The latter sector has seen an increased improvement in higher-end products and accompanying capital intensity, as well as improvements in process efficiency. This has caused a strong increase in capital productivity, as fixed assets become more efficiently utilized. The industry has been actively expanding into new export markets and experienced strong market share growth in China, Hong Kong, Japan and Singapore. Nevertheless, the United States remains as the dominant market for rubber consumption.

The Metal and Metal products sectors are among the major employers among SMEs with a participation rate of 12.9 per cent (Table 7). Malaysian SMEs have responded well to the strong demand and higher prices for iron and steel products in the export market, with a resultant rapid expansion in production. Other major SME employment sectors include Textiles and Apparel as well as Chemical and Chemical products. The textiles and apparel sector is substantially labour-intensive, but is having to adjust to changes (loss of comparative advantage in factor costs) by reducing employment in favour of capital input.

Table 7 Employment Distribution of SMEs in the Manufacturing Sector in 2003

Segment/Industry	Employment by SMEs (%)	Growth in Employment (%)
Food & Beverages	16.6	3.5
Wood & Wood Products	16.2	13.3[1]
Rubber & Plastic Products	13.1	4.4
Machinery & Equipments	4.1	-4.3
Transportation	2.8	1.1
Textile & Apparels	7.2	-6.6[2]
Chemical & Chemical Products	5.3	10.3
Metal & Metal Products	12.9	-
Electrical & Electronics	5.8	-

Source: National Productivity Corporation

Notes:

1. Inclusive of growth in both Furniture (11.4 per cent growth) and Wood and Wood Products (1.9 per cent growth).
2. The total decline of –6.6 per cent is a result of declines in both Textiles (-3.3 per cent) and Apparel (-3.3 per cent).

SMEs in the services sector

According to the Departments of Statistics (DOS) there is a total of 192,527 establishments in the services sector, and 186,728, or 96.7 per cent of these, are SMEs consisting of predominantly micro-enterprises (see Table 8). As shown in Table 9 the Education and Health services sector provides the highest concentration of SMEs, with a total of 98.6 per cent, followed by Wholesale and Retail trade provision that accounts for 97.4 per cent; and selected services, 92.7 per cent. Size of the firm (economies of scale) is a crucial factor in the telecommunication services sector and thus the participation of SMEs in the industry is limited.

Table 8 Distribution of SMEs in the Services Sector (by Size) in 2000

Size of Companies	Amount of Companies	Share (%)
Micro	114,840	59.6
Small	53,612	27.8
Medium	17,976	9.3
Total SMEs	**186,428**	**96.7**
Large	**6,099**	**3.2**
Total	**192,527**	**100**

Source: Department of Statistics

The Wholesale Trade sector, as previously indicated, is the second largest in the services sector with 16,386 enterprises (see Table 10) which account for 8.5 per cent of the total number of enterprises in Malaysia (Table 8). SMEs account for 84.3 per cent of all firms engaged in the Wholesale sector in terms of sales turnover (Table 10). As shown in Table 16.10 most (35.7 per cent) are medium sized enterprises in the sales category between 1 and five RM million. It is worth noting here that volume (for example sales or inventory) is essential in the Wholesale industry that is characterized by low margins and rapid turnover. In terms of contribution to employment by SMEs in the Wholesale Trade sector, micro and small enterprises that employ between 5-19 workers are by far and away the most important. In terms of the profile of the Retail trade sector, this sector is important in linking production and consumption, creating major employment opportunities for the youth and female segment and the self-employed segment. As Table 11 shows the majority of SMEs in this sector are small sized and are mainly proprietorships and family-run businesses. The retail sector is the largest in the services sector with 153,660 companies and 80 per cent of all enterprises. Table 11 indicates that a large percentage of enterprises (66.9 per cent) have a sales volume less than RM200,000, with the majority of them employing less than 5 workers.

Table 9 Distribution of SMEs in the Services Sector (by sector) in 2000

Segment	**Total Amount of Participating Companies**	**Total Amount of Participating SMEs**	**Percentage of Participating SMEs (%)**
Education & Health	8,558	8,438	4.5
Professional Services	5,548	4,840	2.6
Selected Services*	4,146	3,844	2.1
Transportation & Communication	3,908	3,473	1.9
Computer Industry Services	283	186	0.1
Wholesale & Retail Trade	170,046	165,640	88.8
Telecommunication	38	7	0.0
Total	**192,527**	**186,428**	**100**

Source: Department of Statistics

Notes:

* Refers to hotels and other lodging places, travel agencies and tour operator services, share, commodity and foreign exchange brokers, bureau de change, real estate agents, video tape rental services, advertising agencies and motion picture projection services.

Table 10 Profile of SMEs in the Wholesale Trade Sector in 2000

Types	Employment			Sales Turnover		
	No. of Employees	**Amount of SMEs**	**(%)**	**Categories of Sales Turnover (RM)**	**Amount of SMEs**	**(%)**
Micro	< 5	6,508	39.7	< 199,999	2,396	14.6
Small	5 – 19	8,386	51.2	200,000 – 1mill.	5,566	34
Medium	20 – 50	1,094	6.7	1mill. – 5mill.	5,847	35.7
Large	> 50	398	2.4	> 5mill.	2,577	15.7
Total		**16,386**	**100**		**16,386**	**100**

Source: Department of Statistics

Table 11 Profile of SMEs in the Retail Trade Sector in the year 2000

Types	Employment			Sales Turnover		
	No. of Employees	**Amount of SMEs**	**(%)**	**Categories of Sales Turnover (RM)**	**Amount of SMEs**	**(%)**
Micro	< 5	130,773	85.1	< 199,999	102,852	66.9
Small	5 – 19	21,655	14.1	200,000 – 1mill.	40,459	26.3
Medium	20 – 50	816	0.5	1mill. – 5mill.	8,520	5.6
Large	> 50	416	0.3	> 5mill.	1,829	1.2
Total		**153,660**	**100**		**153,660**	**100**

Source: Department of Statistics

The profile of the transportation and communication services sector is summarized in Table 12. From this it can be seen that there are 3,908 enterprises which provide transport and communication services, out of which 89 per cent of these are SMEs. The sector includes the following activities:

- Logistics and freight forwarding services (e.g. shipping)
- Storage and warehousing
- Road haulage
- Sea and inland transport
- Highway operations
- Courier services
- Public bus transport

- Car parking services

Logistic services are important in supplementing the outsourcing of parts and components by MNCs to SMEs. Such services also provide a vital link in trade between industries.

The profile of SMEs in the Professional Services Sector are summarized in Table 13. This sector, as defined under the Malaysian Standard Industrial Classification, consists of the following:

- Non-Technical Related: Legal, Accounting, Business & Management Consultancy, and Advertising.
- Technical Related: Architectural, Engineering, Surveying and other technical activities.

Table 12 Profile of SMEs in the Transportation and Communication Services Sector in 2000

Types	Employment			Sales Turnover		
	No. of Employees	**Amount of SMEs**	**(%)**	**Categories of Sales Turnover (RM)**	**Amount of SMEs**	**(%)**
Micro	< 5	694	17.8	< 199,999	773	19.7
Small	5 – 19	1,935	49.5	200,000 – 1mil	1,429	36.5
Medium	20 – 50	834	21.4	1mil – 5mil	1,271	32.5
Large	> 50	445	11.3	> 5mil	445	11.3
Total		**3,908**	**100**		**3,908**	**100**

Source: Department of Statistics

As shown in Table 13 SMEs compromise the largest component of this sector, contributing 96.9 per cent of the total number of participating enterprises.

3 CONSTRAINTS FACING MALAYSIAN SMEs – REVIEW OF THE LITERATURE

Despite their important contribution to exports, employment and economic growth, there is a wide recognition in the literature about the challenges and barriers facing SMEs in Malaysia, preventing them from growing further and putting them in a critical position to face the new challenges that are arising from globalization, liberalization and extensive organizational, institutional and technological change. It has been documented that the barriers facing SMEs in Malaysia undermine their performance. Some of the existing literature, including Wan (2003); Stuti (2005); Moha (1999); Hall (2002); and SMIDEC (2000), highlight many challenges facing SMEs in a globalized

environment, for example from a lack of financing, low productivity, lack of managerial capabilities, access to management and technology, heavy regulatory burden among many others.

Table 13 Distribution of SME in the Professional Services Sector in 2000

Professional Services	Employment		
	Total Amount of Participating Companies	**Total Amount of Participating SMEs**	**Percentage of Participating SMEs (%)**
Legal	2,639	2,595	98.3
Accounting	991	958	96.6
Architect	730	719	98.4
Engineers	522	478	91.6
Surveying	515	478	92.8
Drafting	151	151	100
Total	**5,548**	**5,379**	**96.9**

Source: Department of Statistics

In the context of this study, however, Malaysian SMEs face many challenges, which have been highlighted by APEC survey (1994); SMI development Plan, 2001-2005 (SMIDEC, 2002); as well as Ting (2004); and UPS (2005). According to the APEC (1994) study SMEs in Malaysia face many challenges, which can be summarized as follows:

1. Lack of a comprehensive framework in terms of policies towards SME development.
2. Agencies use inconsistent definitions to categorize SMEs at the operational level.
3. There are too many agencies, or channels, for SMEs without effective coordination (this leads to a lack of transparency to the target groups).
4. Inadequate data and information on the development of Malaysian SMEs.
5. Inability to be in the mainstream of industrial development.
6. Difficulties in accessing loans and other forms of financial assistance.
7. Many SMEs in Malaysia are still occupying land sites which have not been approved for industrial use purposes.
8. Underutilization of technical assistance, advisory services and other incentives made available by the government and its agencies.
9. Lack of skilled and talented workers, affecting the quality of production as well as efficiency and productivity.
10. Non-leveraging of various incentives which are provided by the promotion of Investment Act, 1986 and the Income Tax Act 1967

According to SMIDP, 2001-2005 study report (SMIDEC, 2002), SMEs in

Malaysia are facing many new challenges, domestically as well as globally. These challenges include the following:

- Intensified global competition
- Competition from other producers (e.g. China and India)
- Limited capability to meet the challenges of market liberalization and globalization
- Limited capacity for technology management and knowledge acquisition
- Low productivity and quality output
- Shortage of skills for the new business environment
- Limited access to finance and capital, and the infancy of venture funds in initial or mezzanine financing
- High cost of infrastructure
- A general lack of knowledge and information

More recently, however, Ting (2004) highlighted many challenges still facing Malaysian SMEs. He identified five key challenges in particular: lack of access to finance; human resource constraints; limited or inability to adopt technology; lack of information on potential markets and customers; and global competition. He also argued that there is a high risk of SMEs being wiped out if they do not increase their competitiveness in the new rapidly developing world of globalization. More recently UPS (2005) conducted a survey to investigate competitiveness issues faced by SMEs in 12 selected Asian countries. This study was based on responses from more than 1,200 Asian SME decision makers during 2004 from across the region. The respondents were from a range of industries, including automotive, garments and textiles, gifts and house-wares, among others. One of the interesting findings from this study was that 73 per cent of respondents considered Chinese SMEs to be more competitive than SMEs in their countries. The survey reported that Filipino and Indonesian SMEs were ranked the least competitive, while Malaysian SMEs were ranked tenth and considered to be competitive by only 27 per cent of respondents. The survey also investigated obstacles to SME competitiveness across Asia. The results showed that innovation and access to market intelligence and other business information, as well as access to funding and capital, are the biggest challenges for SMEs across the region. However, in the context of this study, the UPS survey interviewed 100 Malaysian SMEs to identify key competitiveness issues faced by them. The results indicated that labour cost, innovation and access to funding and working capital, are the main challenges faced by Malaysian SMEs.

4 SME POLICIES AND GOVERNMENT PROGRAMS IN MALAYSIA

After independence (August 1957), Malaysia was a resource based economy, depending on natural resources and exploitation of the land. The industrialization drive laid the foundation for the transformation of the Malaysian economy from resource and agriculture based to industry. The country's industrial strategy was a form of state capitalism aimed at achieving international competitiveness. Malaysia pursued two distinct industrialization strategies. First, the import substitution industrialization (ISI) during the 1960s, and, second, the export oriented strategy during the 1970s and 1980s aimed, especially, at sectors like textiles and electronics (Ching, 2004). Greater emphasis on the development of SMEs, however, only became evident during the early 1970s with the introduction of the New Economic Policy (NEP), 1971-90, aimed at reducing poverty and correcting economic imbalances (Ching, 2004). Real effort towards encouraging and recognizing the importance of SMEs in the country's economy occurred during the 1980s, when the government initiated greater efforts toward encouraging closer linkages between SMEs and larger enterprises.

The government, therefore, put greater effort into strengthening the performance of SMEs by initiating many programs and incentives during the seventh and eighth Malaysian Plans (Government of Malaysia, 2001), as well as during the Second Industrial Master Plan (IMP2). Under IMP2 the government has implemented various policies and strategies. The plan was formulated to enhance the growth of the manufacturing sector through the entire value chain, and encourage cluster-based industrial development. The plan provided an integrated approach to the development of industrial areas and opportunities for growth of SMEs (MITI, 2005).

IMP2 programs to enhance SMEs development, and included in the seventh and eighth Malaysian plans, addressed several issues such as: access to markets; increasing technology capabilities; enhancing the adoption of ICT; and increasing access to finance among others programs (MITI, 1996) (more details below). During the seventh Malaysian plan (1996-2000) period several programs were implemented covering a wide spectrum of SME needs, and is discussed further below. The plan accorded a vital role to SMEs in supporting the national industrialization effort through foreign linkages across the manufacturing sector, since most SMEs operated in this sector. During the eighth plan (2001-2005), as pointed out previously, the majority of SMEs did not have the technological capability to improve production efficiency and product quality (Government of Malaysia, 2001). The government, therefore, undertook strong support in the development of resilient SMEs during the period of this plan, especially in sectors with high

growth and export potential.

As discussed earlier the government's commitment to the development of SMEs is evidenced by IMP2 which ended in 2005, and is to be followed by the Third Industrial Master Plan (IMP3), 2006-2020, which coincides with the country's vision to 2020 (MITI, 2005). The preparation of IMP3 involved the creation of three bodies, an industrial planning committee, a steering committee and nine Technical Resource Groups (TRG). The objective of these groups is to enhance the development of SMEs and analyze achievements under IMP2, and assess the current performance and development profile of SMEs in the manufacturing and selected service sectors. This analysis will form the basis for the formulation of policies and strategies on SMEs to be incorporated into IMP3. Hence TRG will be responsible for undertaking analysis and writing of the necessary documents on the development of SMEs for IMP3. TRG, therefore, recommend new policy directions, strategies, programs and action-plans for the development of competitive, innovative and resilient SMEs in areas such as marketing, new business opportunities and determine the target and key performance indicators of SME performance (MITI, 2005).

In addition, the government, through the National Small and Medium Enterprise development council, plays an important role in SME development and functions. This council consists of 18 key Ministries and Agencies and is chaired by the Prime Minister, and is considered to be the highest policymaking body to discuss the future direction and strategies for SME development. For example, the council has recently taken new initiatives to improve access to financing for SMEs, by introducing an interest subsidy and securitization of SME loans to encourage further lending to them by financial institutions. Other initiatives by this council include: coordinated training and human resource development for SMEs; enhanced management and publication of SME information; strengthening the marketing and promotion of SME products and services; and a small debt resolution scheme for SMEs (BNM, 2004).

According to the Small and Medium Industries Development Corporation (SMIDC) 2001-2005 (SMIDEC, 2002) incentives for SMEs provided by the public sector compromise four instruments, and are summarized in Table 14:

1. Tax incentives to stimulate investment.
2. Grant assistance.
3. Loans, credit and equity participation
4. Infrastructure and supporting services.

These incentives have been structured into broad-based programs designed to strengthen SMEs in the areas of finance, technology acquisition, skills

upgrading, market and infrastructure development (SMIDEC, 2002).

The main programs are:

- **Industrial Linkages Program (ILP)**
  - Promotion and development of SMEs into reliable and competitive suppliers of critical components and services to leading industries.
- **Global Supplier Program (GSP)**
  - Enhance the capacity and capabilities of SME to provide world-class services and products to MNCs in their operations worldwide.
- **Market Development Program**
  - Promotes market opportunities for SMEs.
- **Technology Development Program**
  - Promotes the usage of appropriate technology.
- **Financial Assistance Program**
  - Cuts across all other developmental and assistance programs.
- **Skills Ungrading Program**
  - Enhancing the skills of SME employees
- **Factory Audit Scheme**
  - Enhancing the capability of SMEs
- **Infrastructure Development Program**
  - Assists SMEs in acquiring factory lots that will strengthen their capacity for expansion.

Furthermore, the government, through the small and medium industries development corporation (SMIDEC) [1], continues to promote SME development through the provision of advisory services, infrastructure facilities, market access, and many other supporting programs. Hence, many programs have been developed with the vision of improving the competitiveness and development of SMEs, and are coordinated and administered SMIDEC.

The objectives of these programs are to assist SMEs by:

1. Developing access to markets.
2. Upgrading technology.
3. Promoting the Application of ICT
4. Research & Development (R & D) and Innovation
5. Productivity and Quality
6. Awards and Recognition
7. Access to Financing
8. Supply of Skilled Labour

Each of these is now discussed briefly in turn.

Table 14 Summary of Existing Public Sector Incentives for SMEs

Tax Incentives	Grant Assistance	Loans, Credit & Equity Participation	Infrastructure & Supporting Services
Pioneer Status Investment Tax Allowance (ITA) Reinvestment Allowance (RA) Double deduction of expenses incurred on brand advertising, export promotion, export credit insurance premiums and research & development.	Industrial Technical Assistance Fund (ITAF) Skill Upgrading Program Technology Acquisition Fund (TAF) Commercialization of Research & Development Fund (CRDF) E-Commerce Grant Factory Auditing Scheme	Minimum Lending Guidelines for SMEs Government-Funded Financing Facilities Credit Guarantees for SME Borrowers Equity Financing and Venture Capital	Infrastructure Development Grant Supporting Services: o Technical and business advisory clinics and briefings o Information dissemination and promoting awareness o Product displays and business matching o Promotion of exports by SMEs

Source: SMIDEC and SMIDP (2001-2005)

1. Developing Access to Markets

The government is committed to facilitating the entry of enterprises into export markets. In this regard the Malaysian External Trade Development Corporation (MATRADE) facilitates the participation of SMEs at trade fairs and trade missions by financing their participation costs. To ensure fair competition and opportunities the government has actively participated in trade negotiations and regional and bilateral trade agreements to reduce barriers. To take full advantage of this domestic SMEs must ensure compliance with market requirements in terms of product quality, pricing and delivery schedules. In 2003, 620 applications were approved on matching grants totalling RM3.9million under the Market Development Grant Scheme (MDG) (SMIDEC, 2004).

Another avenue available for SMEs to explore new market opportunities is

through the SMIDEC Annual Showcase (SMIDEX). This event gives SMEs an opportunity to exhibit their goods and demonstrate their service capabilities to potential customers, and assist them to explore possible linkages and networking with MNCs and larger enterprises. In 2003 this event attracted 4,279 trade visitors, facilitated 183 business-matching sessions between 37 MNCs and 50 SMEs. Sales totalling RM3.1million was generated with another RM5.7million yet to be concluded (SMIDEC, 2004). SMIDEC has also established a permanent venue to display parts and components that can be outsourced to SMEs for production. The Physical and Virtual Product Gallery can be viewed physically, or virtually, via its website and SMEs can register their interest on it.

2. Upgrading Technology

As SMEs in Malaysia face increasing challenges and competition as the result of globalization, it is apparent that they need to upgrade their technological capabilities. Technology provides SMEs with the opportunity to increase their efficiency and productivity with tools to better manage their business. Production technologies such as Computer Numerical Control (CNC), Computer Aided Design (CAD), Computer Aided Engineering are some of the technologies which can usefully be adopted by Malaysian SMEs. The government, therefore, provides assistance to upgrade SMEs' technological capabilities by issuing matching grants. Under the Grant for Product and Process Improvement (ITAF2), 403 projects totalling RM21.27million had been funded as at December 2003 (SMIDEC, 2004).

To facilitate the acquisition process, the Technology Development Fund (TAF), administered by the Malaysian Technology Development Corporation (MTDC), was increased from RM125million under the Eighth Malaysian Plan with loans up to 70 per cent or a maximum of RM2million (whichever is lower). So far, 47 SMEs have accessed the scheme worth a total value of RM37.7million.

3. Promoting the Application of ICT

ICT allows effective and speedy communications and can ensure timely responses to market requirements. Thus, SMEs need to develop their ICT capabilities in order to be compatible with, and participate in, the supply chain of MNCs. In this regard, and in order to support the participation of SMEs in the international supply chain, the government provides financial assistance for eligible enterprises to adopt RosettaNet common messenging standards for business communication in the Electrical and Electronics sector. While other sectors are to utilize the ebXMl (e-business Extensible Mark-up

Language) as advised by the United Nations (SMIDEC, 2004).

The Enterprise Resource Planning (ERP) system permits organizations to manage resources across an enterprise and integrate its manufacturing systems while helping to automate and manage back-office operations (for example supply chain management, human resources etc). This will help to improve the efficiency of business operations. Aid was given to SMEs to acquire and implement the ERP solution in 2002 through the e-Manufacturing Grant Scheme. Fast changing market trends and shorter product life cycles are putting mounting pressure on SMEs to respond by adopting the latest technology.

4. Research & Development (R & D) and Innovation

Rising factor costs and competition from lower labour cost economies have eroded the competitive advantage of Malaysian labour intensive manufacturers. To sustain market presence, companies need to move to the higher-end of the value chain. The government, therefore, encourages innovation through R&D via many channels: Ministry of Science, Technology and Innovation (MOSTI) – Industry Research and Development Grant Scheme (IGS) and MTDC – Commercialization of Research and Development Findings (CRDF). As shown in Table 15, under the Eighth Malaysian Plan (RMK8) a total of RM280million was allocated to the IGS and CRDF schemes. R&D promotion as a whole has been allocated a total of RM1.4billion (Table 15). SMIDEC also gives assistance to SMEs involved in product development under the Industrial Technical Assistance program.

Table 15 Grant Allocation for R&D under the Eighth Malaysia Plan (RMK8)

Funds Schemes/Granted	Allocation (RM million)
Commercialization of Research and Development Fund (CRDF)	50
Technology Acquisition Fund (TAF)	125
Industry Research and Development Grant Schemes (IGS)	230
Intensified Research in Priority Area (IRPA)	833
Multimedia Super Corridor Research and Development Grant Schemes (MGS)	100
Demonstrator Application Grant Schemes (DAGS)	90
Total	**1,428**

Source: Eighth Malaysian Plan

5. Productivity and Quality

Financial Support

As indicated earlier, Malaysian SMEs face many challenges in order to be able to compete in a highly competitive international environment. Attaining and maintaining product quality is an important task for Malaysian SMEs. Hence, assistance programs are aimed at encouraging SMEs to acquire quality standards (health, safety, environment and labour) that will assist them to leverage their strengths. For example, matching grants are given to SMEs to attain certifications that verify international standards such as the ISO series, HALAL and GMP. Furthermore, technical assistance is given by the Standards and Industrial Research Institute of Malaysia (SIRIN) to enhance the product quality of SMEs. The Productivity and Quality Improvement Scheme (ITAF3) has benefited 1,704 SMEs with a total approved sum of RM56.7million as of December 2003. Table 16 shows that 1,388 companies have received various types of certification. The ISO 9000 certification is an important first step in this process, and by December 2003 2,022 companies had received this type of certification of which 1,158 had been assisted by SMIDEC.

Table 16 Applications and Approvals in Certifications in 2003

Types of Certification	Applications	Approvals
ISO 9000	1,454	1,158
ISO 14000	24	11
Quality and Productivity	39	29
Product and Certifications	103	75
QS 9000	38	36
HACCP	101	56
Good Manufacturing Practice	17	10
OSHA	3	2
ISO/TS 16949	21	11
TQM	1	0
Total	**1,801**	**1,388**

Source: SMIDEC 2003

6. Awards and Recognition

The Malaysian government, in accord with the importance of productivity and quality (P&Q), has introduced award programs to recognize companies that have achieved excellence through P&Q initiatives. Award programs include the following:

- **The Prime Minister's Industry Excellence Award**
  - In recognition of prestigious quality in management practices
  - Is the most honourable award in the country
  - In 2003, 17 or 57 percent of the total winners were SMEs
- **Productivity and Quality management Award (PQMA)**
  - Introduced by MITI in 1990
  - Aimed at improving management practices by organization wide participation from all levels of employees
  - In 2003, 16 out of 44 winners, or 36 percent, were SME
- **Enterprise 50 Award (E50)**
  - Recognizing the achievements of the top 50 homegrown companies
  - In 2003, the award attracted 114 participants and SMEs formed 44 percent of the total nominations.

7. Access to Financing

The government has allocated a total fund of RM556.6 million for borrowing by SMEs under RMK8, out of which Rm100million was channeled through SMIDEC. An additional fund of RM2.2billion was injected under the Stimulus Package announced in May 2003, of which RM1 billion was allocated to micro enterprises via the Micro Credit Program Scheme. The banking system also recorded RM82billion in loans outstanding to SMEs (SMIDEC, 2004).

SMEs tend to have difficulties in accessing these funds because of a lack of transparency in their business disclosure. This could be solved if SMEs were willing to disclose their financial status, repayment records and managerial capabilities to allow financial institutions to formulate objective financial assessments. In this regard SMIDEC has taken some initiatives in coordination with the Association of Chartered and Certified Accountants (ACCA) and financial institutions to educate SMEs of the importance of prudent financial management.

Through the Credit Guarantee Corporation (CGC) the government is providing guarantees for loan applications by SMEs, as they are perceived by financial institutions to be high-risk borrowers. Bank Negara Malaysia (BNM) recorded a growth of 18.3 per cent in total guarantees outstanding amounting to Rm3billion as at 2003. The government has taken measures to reduce the financing cost and increase accessibility by relaxing loan conditions (for example interest rates, and substituting collateral

requirements with securitization of cash flow). Financial assistance totalling RM51.4million is given to SMEs operating in non-designated areas to acquire their own premises through the SME Relocation Loan Scheme (loans with low interest rates). Such assets can be converted into collateral for further financing in the future.

8. Supply of Skilled Labour

Widespread labour shortages, coupled with the desire to create a knowledge-based economy, has increased the need for technical skills and semi-professionals. In addressing the needs of industrial development, and with the transformation to more knowledge-based production, the government has played an important role in this regard by promoting the development of skills throughout the educational system. Increasing the number of higher-learning institutions is addressing the longer-term requirements of various industries, while short-term programs are being developed to resolve immediate shortages.

In regard to SMEs, SMIDEC collaborates with around 20 skill centres to provide training to local SMEs in technical and managerial skills. The sectors receiving priority in terms of training include Electrical and Electronics, automotive, machinery and engineering services, as SMEs play a major supportive role in these sectors and face an urgent need to meet stringent quality requirements.

To further improve the skills of unemployed graduates, especially in the ICT sector, the government introduced re-skilling schemes in 2001 in order to train these graduates to be certified as Microsoft Certified Systems Engineers (MCSE) and Cisco Certified Network Associates (CGNA). In 2003, 250 graduates were trained at a cost of RM5.2million. Technology based universities (eg. Multimedia University, Universiti Tenaga Nasional) were established and scholarships were provided to help improve the skill level of the labour market. In this regard the government has intensified efforts to attract foreigners and Malaysians working abroad to work in Malaysia, whilst buying out foreign companies in order to build the domestic R&D capability via technology transfer.

16.4 CONCLUSIONS AND SOME POLICY RECOMMENDATIONS

In summary, this chapter has examined and reviewed the extensive literature regarding the development of SMEs in Malaysia; their various contributions to the national economy; challenges they are facing; and the initiatives and

incentives offered by the government and its agencies.

Our review indicates that Malaysian SMEs account for more than 90 per cent of total manufacturing establishments in the country. The evidence suggests that SMEs play a vital role in the nation's economy and wellbeing. The largest concentration of SMEs, in terms of numbers, can be found in the textile and apparel sector, followed by food and beverages, metals and metal products, and wood and wood products.

This review also concluded that the government has implemented many programs designed to strengthen the performance of SMEs. For example, the government initiated around 11 Programs to enhance the contribution of SMEs to the economy and there are more than 10 ministries and 40 government agencies dealing with SME development. Among the programs initiated by the government include the following: the ILP, GSP, market development and financial assistance programs; the establishment of an SME bank (October 2005); and the establishment of a special SME unit at Bank Negara Malaysia to enhance their access to financing.

Despite these governmental programs Malaysian SMEs still face many challenges, domestic and external, which could hinder their resilience and competitiveness. They include:

1. Ongoing difficulties in obtaining funds from financial institutions and the government. Usually the interest charges by financial institutions on loans borrowed by SMEs are high, and this is compounded by a lack of financial transparency by SMEs.
2. A lack of human capital is the most significant challenge facing Malaysian SMEs. It is often too expensive for SMEs to employ a professional and competent workforce.
3. SMEs face a high level of international competition; this includes from AFTA member countries and competition from MNCs or new competitors (for example from China and India).
4. A lack of access to better technology and ICT which hinders more efficient and productive business operations.
5. A high level of bureaucracy in government agencies hinders efficient SME business development operations.
6. A low level of research and development expenditure.
7. A substantial orientation towards the domestic rather than international market place.

Having identified some of the challenges facing SMEs in Malaysia, we prescribed some strategies that the government, and its agencies responsible for SMEs (such as SMIDEC, MCA among many others), and SMEs

themselves may adopt. The government should play a leading role in educating SME practitioners on the incentives available to them and how to access them. These incentives should be delivered through an establishment that really cares for the success and sustainability of SMEs in the country. Delivering government incentives through many channels, including profit-making businesses such as commercial banks, creates confusion among SMEs and opens up the opportunity of a third party (for example a consultant or agent) to gain undue advantage by acting as a mediator between SMEs and the government. This makes access to such incentives cumbersome and expensive for small businesses. The government, therefore, should avoid delivering incentives through too many agencies (especially for-profit-making ones), and also dismantle the bureaucratic procedures that cause inefficiency in government initiatives and projects. The government should increase the number of centres that offer consultancy and expert services to SMEs, and engage more experts in different areas (for example IT, financial planning, marketing planning etc). It should ensure that SMEs get these incentives at a lower cost and in a more effective way. The efficiency and effectiveness of the delivery system of incentives are vital to their utilization.

Regarding poor access to finance, albeit that the government has allocated funds under the Eighth Malaysia Plan and delivered it through its agencies, there are numerous complaints by SMEs regarding the tough qualification criteria for accessing these funds and the bureaucracy in SME related agencies. Besides difficulties in meeting the requirement for these funds, SMEs also have difficulties because of transparency issues. But there has been some positive effort by the government in this regard through the availability of CGC, where the government guarantees loan applications by SMEs regarded as high-risk borrowers. For the CGC to be more effective, however, more flexibility should be applied in the application process to enable more SMEs to receive the guarantee letter.

On the other hand, SMEs in Malaysia should not totally rely on government agencies; they should attempt to find their own path of progress by relying on strategies which allow them to access new markets, increase their revenue and expand their customer base. First, SMEs facing challenges arising from a more integrated and liberalized world (for example from AFTA, or the ASEAN-China free trade agreement), should consider networking and forming strategic alliances as viable options. By identifying and cooperating with these allies, SMEs in Malaysia can gain access to overseas markets, increase sales and revenue, access external sources of funds, gain technological know-how, and become more resilient and stronger to withstand domestic and foreign competitive onslaughts among other benefits.

Second, SMEs should always invest in market research, R&D, and

innovation in order to increase their competitiveness. By embarking on market intelligence they will be better able to understand the needs and wants in the marketplace. Such an understanding will assist in delivering superior value to customers and more than their competitors are able to do. This in turn will increase customer retention rates.

Third, "Small is beautiful" the saying goes. SMEs should therefore leverage the advantages of being small by deploying the relationship marketing strategy. The relatively small customer base of SMEs makes them more suitable for long-term customer relationships. By establishing long-term relationships with customers they are able to build customer loyalty and in turn reduce the cost of operation. Prior research (for example Reicheld 1993; Ndubisi 2003) has shown that it is far cheaper to serve an existing (loyal) customer than to attract and serve a new one.

Lastly, another strategy SMEs should consider is counter-trade. Counter-trade, or reciprocal trade, can assist SMEs in overcoming capital shortages, especially when they contemplate going overseas. A counter-trade strategy can also be used to access closed foreign markets besides allowing for transfer of technology and technological know-how from advanced countries to SMEs in developing nations like Malaysia.

NOTES

1 SMIDEC was established in 1996 to assist with SME development.

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