

## Understanding SMEs in Malaysia

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### Abstract

The role of the Malaysian SMEs is vital to the country's economy and considered to be the backbone of industrial development in the country. Approximately 94% of manufacturing establishments in Malaysia are SMEs. They contribute 27.3% of total manufacturing output, 25.8% to value-added, 27.6% of fixed assets; and 38.9% of employment. In addition, the value added products from SMEs are expected to be worth RM 120 billion or 50% of the total production in the manufacturing sector by 2020. However, the share of SMEs in total exports in the country is around 20% lower than many other countries such as Hong Kong, Taiwan and Philippines. A number of factors are responsible for the (export) productivity paradox of the Malaysian SMEs. These factors are unveiled and recommendations made on how to overcome them.

**Keywords:** SME, Development, Malaysia

### Introduction

SMEs in Malaysia are considered the backbone of industrial development in the country. They play a vital role in the country's economic development. Approximately 94% of manufacturing establishments in Malaysia are SMEs. They contribute 27.3 percent of total manufacturing output, 25.8 percent to value-added, 27.6 percent of fixed assets; and 38.9 percent of employment (SMIDEC, 2002). The majority of SMEs in the country are operating in the Textile and apparel sector, food and beverages, metals and metals products and wood and wood products. In terms of geographical location and distribution, most of the manufacturing companies are located in the central parts of Malaysia and around the major industrial regions. In this paper we review the state of development of SMEs in Malaysia, the contributions of service and manufacturing SMEs to the Malaysian economy, the constraints of SMEs and government support services. The concluding section deals with policy recommendations.

### Definition of SME in the Malaysian Context

Malaysian SMEs has been defined into 2 broad categories as below:

- a. Manufacturing, Manufacturing-related services and Agro-based industries
  - Full-time employees not exceeding 150; OR
  - Annual sales turnover not exceeding RM25 million
- b. Services, Primary Agriculture and Information & Communication Technology (ICT)
  - Full-time employees not exceeding 50; OR
  - Annual sales turnover not exceeding RM5 million

Based on the census conducted by the Department of Statistics in 2000, there were about 20,455 active establishments in the manufacturing sector, of which 18,271 are SMEs. The textiles and apparel sector accounted for around 17 percent of the total, making it the largest SME sector, followed by food and beverages with more than 14 percent, metals and metals products accounted for 14.3 percent and wood and wood products accounted for 13.6 percent (Department of Statistics, <http://www.statistics.gov.my>). According to the department of statistics (2002) there were a total of 192,527 establishments in the service sector, of which 96.8 percent were SMEs. Most of the companies in the services sector (88 percent) were in the retail and wholesale, followed by education and health (4.4 percent), professional services, 2.9 percent and transport and communication (2 percent). The majority of the manufacturing companies in Malaysia

are located in the central parts of Malaysia and around the country's major industrial regions. Johor has the largest concentration of manufacturing companies with 17.5 percent, followed by Selangor 16.7 percent, Perak 9.4 percent and Pulau Pinang 8.7 percent. SMEs in Selangor are predominantly in the transport equipment and electrical sectors, while in Johor there is large concentration in the textiles and apparel and the wood-based sectors. Sectors such as food and food related manufacturers are concentrated in the states of Perak and Johor. Electronics and semi-conductor form the major concentration of the manufacturing companies in Pulau Pinang.

#### **SMEs in the Manufacturing sector**

The activities of the manufacturing SMEs in Malaysia mostly revolve around processing and production of raw materials such as food, beverage, textile, petroleum, wood, rubber, assembling and manufacturing of electrical and electronics appliances, and components. According to SMIDEC (2002), SMEs contributed 27.3 percent of total manufacturing output, 25.8 percent of value-added and 38.9 percent of employment. According to National Productivity Corporation (NPC) the output of SMEs has grown by 9.7 percent during 2002-03, value added expanded by 11.8 percent and employment by 3.7 percent, due to the improvement in the labour productivity in Malaysian SMEs. Table 1 shows the contribution of this sector to employment, output, and to value-added as well as their growth.

**Table 1 Distribution and Contribution of Malaysian SMEs in the Manufacturing Sector**

<b>Segment</b>	<b>No. of Establishments</b>	<b>No. of SMEs</b>	<b>Contribution to Output (%)</b>	<b>Growth in Output (%)</b>	<b>Contribution to Value-added (%)</b>	<b>Growth in Value-added (%)</b>	<b>Employment (%)</b>
<b>Food &amp; Beverages</b>	2,949	2,749	30.6	9.1	19.8	16.3	16.6%
<b>Wood &amp; Wood Products</b>	2,776	2,582	8.3	11.5	9.6	16.3	16.2%
<b>Rubber &amp; Plastic Products</b>	482	366	10.8	8.8	12.2	13.3	13.1%
<b>Machinery &amp; Equipments</b>	1,249	1,135	2.9	8.9	4.2	11.3	4.1%
<b>Transportation</b>	507	433	2.5	-2.3	3.3	-0.5	2.8%
<b>Textile &amp; Apparels</b>	3,419	3,319	2.2	1.2	3.2	4.7	7.2%
<b>Chemical &amp; Chemical Products</b>	712	526	11.9	10.6	12.6	16.3	5.3%
<b>Metal &amp; Metal Products</b>	2,918	2,709	13.6	-	13.9	-	12.9%
<b>Electrical &amp; Electronics (E&amp;E)</b>	907	543	5.2	-	5.1	-	5.8%
<b>Non Metallic</b>	893	803	4.8	10.5	6.6	13.7	-

<b>Mineral Products</b>	
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*Source: SMIDEC, NPC, Saleh and Ndubisi*

As shown in Table 2, the food and beverage sectors contributed the highest output (30.6 percent) followed by Metal and Metal products, then by chemical and chemical products. Furthermore, E&E owns a total contribution of 23.1 percent to the manufacturing output, but only 5.2 percent are SMEs. In terms of employment distribution in the manufacturing sector, according to National Productivity Corporation (NPC), the shares of employment in the sectors, exceeding output and value-added contribution, reflect the labour-intensive nature of furniture and apparel production. Metal and Metal products sector is among the major employers among SMEs with a participation of 12.9 percent. According to SMIDEC (2004), the manufacturing sector is characterized by the following four features: (1) Low levels of technological capabilities (e.g. employs labour-intensive modes of production and dependent on personal technology; and low level of technology caused by inadequate capital investments constrains the potential growth of SMEs by failing to meet market requirements); (2) Low levels of research and development (R&D); (3) Substantial orientation towards domestic markets; and (4) Internal sourcing of funds (failure to exploit outside sources of financing).

### **The Service Sector**

There are 192,527 establishments in the services sector and 186,728 or 96.7 percent are SMEs (Department of Statistics). As shown in Table 2, the wholesale & retail sector constitutes 89 percent of all SMEs, followed by education & health in the far second position, and then professional services. Transportation and communication services sector include activities such as logistics and freight forwarding services, storage and warehousing, sea and inland transport, and highway operations.

**Table 2 Malaysian SMEs: Distribution in the Services Sector (by sector)**

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

*Source: Department of Statistics; Saleh and Ndubisi, 2006)*

### **Constraints of SME Development in Malaysia**

SMEs, especially in developing countries face many challenges. Studies (e.g. SMIDEC, 2002; Saleh & Ndubisi, 2006; Stuti, 2005) have identified some of the barriers facing SMEs in developing countries. Wang (2003) listed the challenges of SMEs in a globalized world such as, low productivity, access to

management and technology, lack of financing and lack of managerial capabilities. The Malaysian SMEs face many challenges which have been identified in past studies such as APEC (1994), SMIDEC (2004), Ting (2004), and Saleh and Ndubisi (2006). SMIDEC (2004) listed the following obstacles of the Malaysian SMEs: low level of technological adoption, low level of research and development (R&D), substantial orientation towards domestic markets, and limited sources of funds. It is recognized as well that tariff and non-tariff barriers (e.g. inspection practices, standards for labelling, work permit, among many others) are major obstacles for SMEs in exporting (APEC 1994). Saleh and Ndubisi (2006) prescribed strategies for growth and sustainability of Malaysian SMEs namely, adoption of reciprocal trade, adoption of relationship-based marketing, less reliance on government incentives, leveraging cheaper sources of R&D provided by SME research centres and Universities (Saleh & Ndubisi 2006). On the part of the government, the authors recommended the use of minimal delivery channels for incentives, increase in the number of centres offering specialized training services to SMEs and annihilation of bureaucratic procedures of agencies providing services to SMEs.

In spite of their roles and contributions to economic growth, employment and exports, literature has documented many barriers facing Malaysian SMEs. For example, SMIDP's 2001-2005 study identified many challenges which are facing Malaysian SMEs at both domestic and international level (SMIDEC, 2002):

1. Intensified global competition
  - Trade agreements (eg. multilateral, bilateral, regional) made markets more readily accessible and soared competition.
  - Timely market intelligence and the ability to compete on the basis of quality, cost and speedy delivery (QCD) will be critical factors.
2. Competition from other producers
  - Competition from lower labour cost countries (eg. China, India) are expected to erode the market share of SMEs.
3. Limited capability to meet the challenges of market liberalisation and globalisation
  - Most SMEs are dependent on small and protected domestic market that deters them from upgrading their technological and management capabilities, thereby limiting their ability to meet global standards.
  - Without assistance, SMEs face high barriers to entry in penetrating the exports markets because of high transaction and information costs.
4. Limited capacity for technology management and knowledge acquisition
  - Technology and knowledge investments will ensure SMEs are able to monitor and respond to new opportunities in a timely and effective manner.
  - But content provision is still lacking in many areas and is costly for SMEs to acquire on their own.
5. Low productivity and quality output
  - Technology capabilities and the ability to meet specified manufacturing standards determine the opportunity of SMEs to participate in the global supply chain.
  - SMEs face the challenge of constantly upgrading their productivity through automation (increase efficiency and lower product costs) in order to participate in the global supply chain.
6. Shortage of skills for the new business environment
  - Continuing dependence of SMEs on foreign labour delays the investment in automation, skills upgrading and knowledge acquisition that are critical to long-term competitiveness.
  - Supply of skilled labour is still scarce, resulting in high staff turnover at the enterprise level and impeding output expansion.
7. Limited access to finance and capital, and the infancy of venture funds in initial or mezzanine financing

- SME traditionally finance its operation through personal savings, loans from family members and friends, as well as supplier credits.
  - New start-ups often face difficulties in securing credit, as they have built little collateral or track record.
8. High cost of infrastructure
- Majority of SMEs are still located on land not designated for industrial use and the dispersed pattern of SMEs has impeded the full realisation of synergies in the industry clusters.
  - There are also difficulties of providing common user facilities, thus affecting the ability of SMEs to comply with requirements demanded by their customers.
9. General lack of knowledge and information

Ting lists the following challenges (Ting 2004): (1) human resource constraints; (2) lack of access to finance; (3) inability to adopt technology; and (4) lack of information on potential markets. He also argued that Malaysian SMEs are in a critical position to be wiped out if they do not improve their competitiveness in the new world of globalization. Saleh and Ndubisi (2006) identify some of the hindrances to the development of the Malaysian SMEs. They include the following:

1. Red tape applied by government agencies in delivering incentives. This hinders the speed of new business development and efficiency in the operations of Malaysian SMEs.
2. Difficulty in obtaining funds from financial institutions. Commercial banks consider SMEs as high risk ventures and are often reluctant to lend to them without adequate collateral which many SMEs don't have, and Micro finance institutions are not well developed to meet the mounting financial needs of SMEs.
3. Lack of human capital is one of the most significant challenge for Malaysian SMEs. It is often very expensive for Malaysian SMEs to employ professional and skilled people; when they do, they find it difficult to keep them with their poor career development plans. In fact many SMEs still treat their staff as resources (something to use) instead of as capital (something of value to cherish).
4. SMEs in Malaysia face high level of international competition due to globalisation, these include AFTA and competition from MNCs and new competitors (e.g. China, India).
5. Poor access to new technologies and underutilisation of existing ones. Landauer (1995), Sichel (1997) and Ndubisi and Jantan (2003) have linked the gross under-utilization of systems to the productivity paradox.
6. Resistance to change including reluctance to experiment with new technologies and new business practices.

### Conclusions

This paper reviews the development, contributions and challenges of SMEs in Malaysia. It is clear that SMEs in Malaysia play an important role in the nation's economic development. The largest number of concentration of SMEs is in the textile and apparel sector, followed by food and beverages, metals and metals products, wood and wood product. In terms of geographical location, Johor has the largest concentration of manufacturing companies, followed by Selangor. The SMEs in Selangor are predominantly in the transport equipment and electrical sectors while in Johor there is larger concentration in the textiles and apparel and the wood-based sectors.

SMEs in Malaysian still face many challenges domestically in achieving economies of scale and globally, due to competition from foreign firms. Among the challenges are low levels of technological capabilities and lack of skilled human capital, low levels of research and development (R&D), substantial orientation toward domestic markets, high level of international competition, high level of bureaucracy in government

agencies; and heavy reliance on internal sources of funds. In addition to that, it is recognized as well that tariff and non-tariff barriers are major obstacles for SMEs in exporting (APEC 1994).

Identifying the challenges, which are facing Malaysian SMEs, is a good step towards formulating a workable framework for those SMEs to overcome some of the problems. For example, as Malaysian SMEs face challenges from more integrated and liberalized world (e.g. AFTA, ASEAN-China), and as many of them do not have the capabilities of some of their foreign rivals, effective responses would be through networking and strategic alliances, as such interaction can assist them to cooperate and grow with their allies.

The Malaysian government has important roles to play in creating resilient and competitive SMEs that are capable of competing at the international level. The recent Malaysia plan (9MP) (2006-2010) shows that the government is clear about its roles in this regard. Five key thrusts emphasized in the plan are:

1. Moving the Malaysia economy up the value chain (with a focus on increasing productivity, competitiveness and value-add in agriculture, manufacturing and services sector; generating new sources of wealth in technology, ICT and skill-based services; and expanding the market for Malaysian products and services).
2. Raising the capacity for knowledge and innovation, and nurturing “first class mentality” (including holistic human capital development encompassing knowledge, skills, progressive attitudes & thinking, strong moral & ethical values; and nurturing top-quality R&D, science and innovation).
3. Addressing persistent socio-economic inequalities constructively and productively (such as developing competitive “Bumiputra” entrepreneurs; reducing disparities in development between states, regions as well as between rural and urban states; reducing disparities in income, employment and wealth ownership).
4. Improving the standard and sustainability of the quality of life (with emphasis on improving infrastructure and urban transportation system; ensuring environmental conservation and sustainable resource management; and improving adequacy and sustainability of energy supply, and health care services).
5. The focus of the last thrust is strengthening the country’s institutional and implementation capacity (by promoting good governance, enhancing the public service delivery system and development through international cooperation).

Government’s effort to intensify competitiveness, productivity and value of established sectors such as SMEs is a clear demonstration of an understanding of the barriers facing the sector and genuine effort to assist it overcome some of these challenges. Moreover, the emphasis on human capital development which is a prerequisite for value and wealth creation would ensure that SMEs have access to skilled human capital. The allocation of RM 3.9 billion for R&D in the 9MP, which is 97.3 percent higher than the allocation in the 8MP is intended to ensure that Malaysian firms (including SMEs) increase their innovative capacity.

Nevertheless, business owners are almost unanimous in their opinion that a major problem with the government’s initiatives to support SMEs is the delivery process. Practitioners believe that delivering government incentives through too many channels and those with conflicting interests creates confusion and opens up the opportunity for third parties (e.g. consultant or agent) to take undue advantage by acting as a profiteering mediators between the SMEs and the government. The government should therefore avoid delivering incentives through too many channels and channels with potentially bureaucratic processes and conflicting interest. The effectiveness and efficiency of the delivery systems of incentives are as important as their creation.

On the issue of poor access to finance, the government of Malaysia has allocated large amounts under the Eight Malaysia Plan (8MP) and the ones before it, but SMEs still had difficulties accessing these funds. Commercial banks’ loans, micro-financing and free interest loans are often inaccessible for reasons such as

transparency issues, dearth of precise business plan, poor book keeping and lack of collateral. Effort by the government in this regard through the credit guarantee corporation (CGC) initiative whereby the government guarantees loan application by SMEs considered high-risk borrowers is commendable and should be enhanced.

It is also germane to add that SMEs in Malaysia should strive to be more independent and create own competitiveness, rather than increased reliance on the government. The 9MP as its second thrust prescribes raising the capacity for knowledge and innovation and nurturing “first class mentality”. SMEs in Malaysia should find their own path to competitiveness and sustainability by developing strategies that can attract and retain customers for the long term. SMEs should recognise the need to invest in market research, business network, R&D, innovation, quality workforce, new product design, product differentiation and information and communication technologies.

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