

An Evaluation of SME Development in Malaysia

Ali Salman Saleh* and Nelson Oly Ndubisi**

Small and medium enterprises (SMEs) in play a vital role in the Malaysian economy and are considered to be the backbone of industrial development in the country. However, few studies examined their development, challenges and future prospects. Therefore, the aim of this paper is to examine and analyse the role of SMEs in different sectors as well as their major contribution to the economy. The paper goes further to review the existing literature as well as the empirical studies in order to identify the major challenges (domestically and globally) that face this sector. The key messages from the studies examined in this paper are that Malaysian SMEs still face many domestic and global challenges in achieving economies of scale and competing internationally. Among the challenges are the low level of technological capabilities and limited skilled human capital resources, a low level of technology and ICT penetration, low levels of research and development (R&D), a substantial orientation towards domestic markets, a high level of international competition (for example, from China and India), a high level of bureaucracy in government agencies, and internal sourcing of funds. These characteristics suggest that government programs and incentives are either insufficient or not delivered effectively enough to overcome these problems. This paper attempts to identify the challenges as a positive first step towards formulating a workable framework for the SMEs to overcome them.

Keywords: SMEs, development, contributions, challenges, Malaysia.

1. Introduction

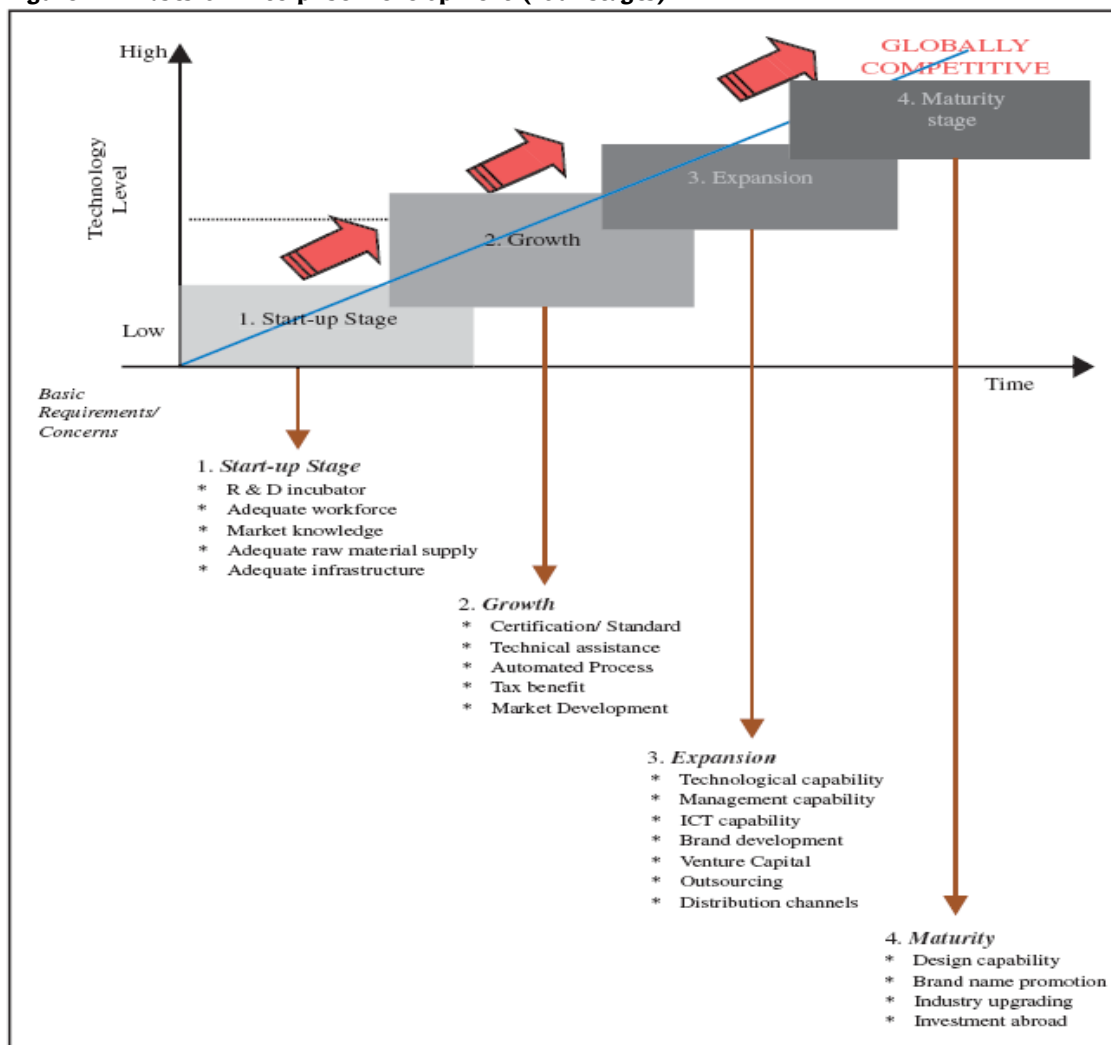
Malaysian SMEs are a vital component of the country's economic development. According to SMIDEC (2002), SMEs accounted for 93.8 per cent of companies in the manufacturing sector. They contribute 27.3 per cent of total manufacturing output, 25.8 per cent to value-added production, own 27.6 per cent of fixed assets, and employ 38.9 per cent of the country's workforce. In addition, value-added products from SMEs are expected to be worth RM 120 billion — or 50 per cent of total production — in the manufacturing sector by 2020. Despite these statistics, Malaysian SMEs' share of total exports is approximately 20 per cent lower than many other countries', such as the Philippines, Hong Kong, Taiwan and even the US (SMIDEC, 2002). SMEs in Malaysia are concentrated in the textile and apparel, food and beverages, metals and metals products and wood and wood products sectors. The majority of manufacturing companies are located in the central parts of Malaysia and around the country's major industrial regions.

* Dr Ali Salman Saleh, is presently a Lecturer of Economics at the School of Economics and Information System, University of Wollongong: ali@uow.edu.au

** Dr. Nelson Oly Ndubisi, is presently Associate Professor of management at the School of Business, Monash University Malaysia: nelson.ndubisi@buseco.monash.edu.my

The Malaysian Government's commitment to, and concern for, the development of SMEs has been clearly evident since the early 1970s. The 'New Economic Policy' was introduced in 1971, which aimed to improve people's welfare and restructure ethnic economic imbalances. The government's commitment to the development of SMEs can also be seen in the second Industrial Master Plan (IMP2), which ended in 2005, which is followed by the Third Industrial Master Plan (IMP3) 2006–2020, to coincide with the country's vision for 2020 (MITI, 2005). The Malaysian Government has implemented various policies and strategies under these plans. The IMPs were formulated to enhance the growth of the manufacturing sector across the entire value chain and cluster-based industrial developments. Hence, this plan provides an integrated approach to the development of industrial areas and opportunities for growth of SMEs (MITI, 2005). Figure 1, below, shows the phases of development of enterprises in Malaysia

Figure 1: Phases of Enterprise Development (four stages)



Source: SMIDEC, 2002

Small and medium enterprises in many countries face myriad challenges. At the theoretical level, studies have identified some of the barriers to SMEs' growth, for example, Wan, 2003; Stuti, 2005; Moha, 1999; Hall, 2002; and SMIDEC, 2002. Wan (2003) in particular highlighted many challenges facing SMEs in a globalised environment, for example, lack of financing, low productivity, lack of managerial

capabilities, poor access to management and technology, and heavy regulatory burdens, among others. In the Malaysian context, SMEs have particular challenges, and these have been highlighted by the APEC survey (1994), the SMI Development Plan 2001–2005 (SMIDEC, 2002), Ting (2004), the UPS survey (2005), and others. These sources identified lack of access to loans, limited adoption of technology, lack of human resources, lack of access to loans, competition from MNCs and globalisation. This study aims to analyse and discuss the development of Malaysian SMEs, their roles and various contributions to the national economy. The paper also reviews extant literature to identify the major challenges facing this sector in Malaysia, as well as government policies directed towards SMEs.

2. Profile of SMEs

Malaysian SMEs can be defined according to size, turnover and activity. Those relevant to this paper find SMEs in Malaysia falling into two broad categories:

1. Manufacturing, manufacturing-related services and agro-based industries, which have either:
 - fewer than 150 full-time employees; *or*
 - an annual sales turnover of less than RM25 million.
2. Services, primary agriculture and information and communication technology (ICT), which have either:
 - fewer than 50 full-time employees; *or*
 - an annual sales turnover of less than RM5 million.

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

Table 1 Definition of SMEs in Malaysia

	Category	Micro-enterprise	Small enterprise	Medium enterprise
1.	Manufacturing, manufacturing-related services and agro-based industries	Sales turnover of less than RM250,000 <i>or</i> fewer than five full-time employees.	Sales turnover between RM250,000 and RM10 million <i>or</i> between five and 50 full-time employees.	Sales turnover between RM10 million and RM25 million <i>or</i> between 51 and 150 full-time employees.
2.	Services, primary agriculture and information and communication technology (ICT)	Sales turnover of less than RM200,000 <i>or</i> fewer than five full-time employees.	Sales turnover between RM200,000 and RM1 million <i>or</i> between five and 19 full-time employees.	Sales turnover between RM1 million and RM5 million <i>or</i> between 20 and 50 full-time employees.

Source: SMIDEC

In terms of the total numbers of SMEs in the country, the 2000 census conducted by the Department of Statistics showed that there were 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 these 18,271 (or 89.3 per cent) were SMEs. The textiles and apparel sector accounted for approximately 17 per cent of the total, making it the largest. This sector is followed in size by food and beverages (greater than 14 per cent), metals and metals products (14.3 per cent) and wood and wood products (13.6 per cent). The 2000 census also captured a total of 192,527

establishments in the service sectors, of which, 96.8 per cent were SMEs. Most of the companies in the services sector (88 per cent) were in the retail and wholesale, followed by education and health (4.4 per cent), professional services (2.9 per cent) and transport and communication (two per cent).

Table 2 Distribution of SMEs by Size

Type	Number of Establishments	Share (per cent)
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	20,455	100.0

Source: Malaysian Department of Statistics, *Census 2000*

As shown in Table 3, the largest concentration of SMEs were in the textile and apparel sector (18.2 per cent), followed by food and beverages (15.2 per cent), metals and metals products (14.8 per cent) and wood and wood products (14.1 per cent).

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

Sector	Number of establishments	SMEs	Proportion of SMEs (per cent)
Textiles and apparel	3,419	3,319	18.2
Food and beverages	2,949	2,749	15.2
Metal and metal products	2,918	2,709	14.8
Wood and wood products	2,776	2,582	14.1
Paper, printing, publishing	1,288	1,195	6.5
Machinery and engineering	1,249	1,135	6.2
Plastic products	1,121	988	5.4
Electrical and electronics	907	543	3.0
Non-metallic mineral products	893	803	4.4
Other (jewellery)	733	666	3.6
Petrochemical and chemical	712	526	2.9
Transport equipment	507	433	2.4
Rubber and rubber products	482	366	2.0
Palm oil and palm oil products	434	155	0.8
Leather	67	65	0.4
Total	20,455	18,271	100.0

Source: SMIDEC, 2004

In terms of geographical location, the majority of manufacturing companies in Malaysia were found to be located in the West Coast of Malaysia, which is industrialised and has ports facilities. Johor has the largest concentration of manufacturing companies such as textiles and apparel and the wood-based industries because of the availability of cheap labour and logging activities, 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 the wood-based sectors. The majority of other sectors (such as food and food-related manufactures) are concentrated in the states of Perak and Johor. This is likely

due to the vast forest concentration in Johor and Perak, and somewhat deforestation in Selangor to provide communication and transportation infrastructure to link the nation's capital city with other parts of Malaysia and the world.

2.1 SME sectors in Malaysia

As previously mentioned, SMEs in Malaysia account for a large proportion of the total business in various sectors, and contribute a considerable share in terms of GDP. As in many other countries, SMEs in Malaysia are involved in a diverse range of industries. In determining the importance of SMEs in the country, especially in terms of their economic contribution, it is important to classify or categorise the SMEs in Malaysia. Hence, we first examine manufacturing and service SMEs.

2.1.1 SMEs in the Manufacturing Sector

Small and medium enterprises in the Malaysian manufacturing sector are involved in activities such as processing and production of raw materials, for instance, food, beverages, textiles, petroleum, wood, rubber and the assembling and manufacturing of electrical and electronics appliances and components, among others (see Table 3). Malaysian SMEs account for more than 90 per cent of the total manufacturing establishments in the country. According to SMIDEC (2002), SMEs contributed 27.3 per cent of the total manufacturing output, 25.8 per cent of value-added products and contributed to 38.9 per cent of employment. As indicated in Table 4, below, the output of SMEs has grown by 9.7 per cent during 2002–03, value added production has expanded by 11.8 per cent and employment by 3.7 per cent — all due to the improvement in labour productivity in Malaysian SMEs. Table 4 also indicates that the share of employment by SMEs has expanded from 31.5 per cent in 2002 to 32.5 per cent in 2003, due to the growth in employment of 3.7 per cent contributed by SMEs.

Table 4 Contribution of SMEs in the Manufacturing Sector

Indicators	Value		Share Contributed to Manufacturing Sector output (per cent)		Annual Growth (per cent)
	2003	2002	2003	2002	
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, below, the increase in labour cost per employee of 7.3 per cent closely matches the increase in value adding per employee of 7.8 per cent, implying a tight labour market. Therefore, in order to improve further the competitiveness of SMEs in the country, a reduction in unit labour cost is needed. However, in terms of SMEs' performance in the manufacturing sector, according to the National Productivity Corporation, in 2003 this sector performed well in all the key economic indicators. Table 6, below, shows the contribution of this sector to output, and to value-added products, as well as their growth.

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 (number)	2.0	0.4
Unit labour cost (number)	0.1	1.6
Capital Productivity		
Fixed assets per employee (RM)	35,792	4.0
Added value per fixed asset (number)	1.1	3.6

Source: National Productivity Corporation

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

Segment	Contribution to Output (per cent)	Growth in Output (per cent)	Contribution to Value-Added Products (per cent)	Growth in Value-Added Products (per cent)
Food and beverages	30.6	9.1	19.8	16.3
Wood and wood products	8.3	11.5 [^]	9.6	16.3 [•]
Rubber and plastic products	10.8	8.8	12.2	13.3
Machinery and equipment	2.9	8.9	4.2	11.3
Transportation	2.5	-2.3	3.3	-0.5
Textile and apparels	2.2	1.2 [*]	3.2	4.7 [#]
Chemical and chemical products	11.9	10.6	12.6	16.3
Metal and metal products	13.6	-	13.9	-
Electrical and electronics (E&E)	5.2	-	5.1	-
Non-metallic mineral products	4.8	10.5	6.6	13.7

Source: National Productivity Corporation

[^] Inclusive of growth in both furniture (6.3) and wood and wood products (5.2).

[•] Inclusive of growth in both furniture (8.0) and wood and wood products (8.3).

^{*} Growth in apparels was 2.0, while textiles had a -0.8 decline. Total growth was 1.2 for 'textiles and apparels'.

[#] Growth in apparels was 3.5, while growth in textiles was 1.2. Total growth was 4.7 for 'textiles and apparels'.

Table 6, above, also shows that the food and beverage sectors contributed the highest output (30.6 per cent), followed by metal and metal products (13.6 per cent), then chemical and chemical products. In addition, E&E had a total contribution of 23.1 per cent to the manufacturing output; but only 5.2 per cent belongs to SMEs, implying the dominance of multinational corporations (MNCs) in the industry. The decline in the output of motor vehicles and transportation were 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 the SME supply of parts and components.

As can be seen from Table 7, below, the food and beverages sector has the highest rate of employment (16.6 per cent), due to 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. The wood and wood products sector has had a positive impact on capacity expansion and technological upgrading, and has the second-highest rate of participation (16.2 per cent), followed by rubber and plastic products (13.1). This sector has seen increased improvement in higher-end products

and an accompanying capital intensity, as well as improvements in process efficiency. This has caused a strong increase in capital productivity, because of fixed assets becoming more efficiently utilised. 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 US remains the dominant market in rubber consumption.

Table 7 Employment Distribution of SMEs in the Manufacturing Sector

Segment/Industry	Employment by SMEs (per cent)	Growth in Employment (per cent)
Food and beverages	16.6	3.5
Wood and wood products	16.2	13.3*
Rubber and plastic products	13.1	4.4
Machinery and equipments	4.1	-4.3
Transportation	2.8	1.1
Textile and apparels	7.2	-6.6#
Chemical and chemical products	5.3	10.3
Metal and metal products	12.9	-
Electrical and electronics	5.8	-

Source: National Productivity Corporation

* Inclusive of growth in both furniture (11.4) and wood and wood products (1.9).

The total decline of -6.6 is a result of declines in both textiles (-3.3) and apparels (-3.3).

The metal and metal products sectors are among the major employers in SMEs, with a participation of 12.9 per cent (see 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 rapid expansion in production. Other major employers include textiles and apparels as well as chemical and chemical products. The textile and apparels sector is substantially labour intensive, but tends to adjust to changes (for instance, a loss of advantage in factor costs) by reducing employment in favour of capital input.

2.1.3 SMEs in the Services Sector

According to the Department of Statistics (DOS), there are 192,527 establishments in the services sector, and 186,728 (or 96.7 per cent) of these are made up of SMEs. As shown in Table 8, below, the education and health services sector has the highest concentration of SMEs, with a total of 98.6 per cent, followed by wholesale and retail trade provision, which accounts for 97.4 per cent, and selected services (92.7 per cent). The size of the firm (economy of scale) is a crucial factor in the telecommunication services sector, and thus the participation of SMEs in that industry is limited. The wholesale trade sector is the second largest in the service sector, with 8.5 per cent of the total 192,527 enterprises (see Table 9). SMEs account for 84.3 per cent of all firms engaged in the wholesale sector, in terms of sales turnover (see Table 10). As shown in Table 10, below, the majority (35.7 per cent) is in the medium sales category, between RM1 million and RM5 million. It is worth noting here that volume (for example, sales and inventory) is essential in a wholesale industry that is characterised by low margins and rapid turnover. The majority of SMEs in the wholesale trade sector are micro and small enterprises and employ between five and 19 workers. 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, female and self-employed segments. As Table 10 shows, the majority of SMEs in this sector are small in size and are mainly proprietorships and family-run businesses.

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

Size of Companies	Number of Companies	Share (per cent)
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

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

Segment	Total Number of Participating Companies	Total Number of Participating SMEs	Percentage of Participating SMEs (per cent)
Education and health	8,558	8,438	4.5
Professional services	5,548	4,840	2.6
Selected services*	4,146	3,844	2.1
Transportation and communication	3,908	3,473	1.9
Computer industry services	283	186	0.1
Wholesale and RETAIL TRADE	170,046	165,640	88.8
Telecommunications	38	7	0.0
Total	192,527	186,428	100

Source: Department of Statistics

* 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

Types	Employment			Sales Turnover		
	Number of Employees	Number of SMEs	(per cent)	Category of Sales Turnover (RM)	Number of SMEs	(per cent)
Micro	< 5	6,508	39.7	< 199,999	2,396	14.6
Small	5–19	8,386	51.2	200,000 to 1 million	5,566	34
Medium	20–50	1,094	6.7	1 million to 5 million	5,847	35.7
Large	> 50	398	2.4	> 5 million	2,577	15.7
Total		16,386	100		16,386	100

Source: Department of Statistics

The retail sector is the largest of the services sector, with 153,660 companies and covering 80 per cent of all enterprises. Table 11, below, indicates that a large percentage of enterprises (66.9 per cent) have a sales volume of less than RM200,000. The majority of these employ fewer than five workers. Hence, this sector plays an important role by linking production and consumption, and creating major

employment opportunities, especially for the youth, female and self-employed segments of the labour force. Many of them are sole proprietorships and family-run businesses.

Table 11 Profile of SMEs in the Retail Trade Sector

Types	Employment			Sales Turnover		
	Number of Employees	Number of SMEs	(per cent)	Category of Sales Turnover (RM)	Number of SMEs	(per cent)
Micro	< 5	130,773	85.1	< 199,999	102,852	66.9
Small	5–19	21,655	14.1	200,000 to 1 million	40,459	26.3
Medium	20–50	816	0.5	1 million to 5 million	8,520	5.6
Large	> 50	416	0.3	> 5 million	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 summarised in Table 12, below. This sector includes the following activities:

- logistics and freight forwarding services (for example, 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 multinational companies (MNCs) to SMEs. Such services also provide vital links in trade between industries. As shown in Table 12, below, there are 3,908 enterprises that provide transport and communication services, and of them, 89 per cent are SMEs.

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

Types	Employment			Sales Turnover		
	Number of Employees	Number of SMEs	(per cent)	Category of Sales Turnover (RM)	Number of SMEs	(per cent)
Micro	< 5	694	17.8	< 199,999	773	19.7
Small	5–19	1,935	49.5	200,000 to 1 million	1,429	36.5
Medium	20–50	834	21.4	1 million to 5 million	1,271	32.5
Large	> 50	445	11.3	> 5 million	445	11.3
Total		3,908	100		3,908	100

Source: Department of Statistics

The profile of SMEs in the professional services sector is summarised in Table 13. This sector is defined under the Malaysian Standard Industrial Classification as follows:

- non-technical related: legal, accounting, business and management consultancy, advertising
- technical related: architectural, engineering, surveying and other technical activities.

As shown in Table 13, below, SMEs comprise the largest component of this sector, comprising 96.9 per cent of the total enterprises that participate in this sector.

Table 13 Distribution of SMEs in the Professional Services Sector

Professional Services	Employment		
	Total Number of Participating Companies	Total Number of Participating SMEs	Percentage of Participating SMEs (per cent)
Legal	2,639	2,595	98.3
Accounting	991	958	96.6
Architectural	730	719	98.4
Engineering	522	478	91.6
Surveying	515	478	92.8
Drafting	151	151	100
Total	5,548	5,379	96.9

Source: Department of Statistics

3 Constraints on Malaysian SMEs — Review of the Literature

Apart from their role in terms of their contribution to exports, employment and economic growth, there is a wide recognition in the literature about the challenges and barriers facing Malaysian SMEs. These prevent them from growing further and put them in a critical position to face the new challenges that are arising from globalisation, liberalisation and extensive organisational, institutional and technological change. It has been documented that the barriers facing SMEs in Malaysia undermine their performance. Some of the existing literature includes Wan (2003); Stuti (2005); Moha (1999); Hall (2002); and SMIDEC (2000). Wan (2003) highlighted many challenges facing SMEs in a globalised environment, for example, lack of financing, low productivity, lack of managerial capabilities, access to management and technology, and heavy regulatory burdens, among many others.

However, in the context of this study, Malaysian SMEs face many other challenges that have been highlighted by APEC survey (1994); SMI development Plan 2001–2005 (SMIDEC, 2002); as well as Ting (2004); and UPS (2005). According to an APEC study (1994), the SMEs in Malaysia are facing many challenges, which can be summarised as follows:

1. There is a lack of comprehensive framework in terms of policies towards SMEs development.
2. Agencies use inconsistent definitions to categorise SMEs at the operational level.
3. There are too many agencies or channels for SMEs without effective coordination (this leads to lack of transparency to the target groups).
4. There is inadequate data and information on the development of Malaysian SMEs.
5. There is an inability to be in the mainstream of industrial development.
6. There are difficulties in accessing loans and other forms of financial assistance.
7. Many SMEs in Malaysia still occupy lands or sites that are not approved to be used for industrial purposes.
8. There is an underutilisation of technical assistance, advisory services and other incentives made available by the government and its agencies.
9. There is a lack of skilled and talented workers, which affects the quality of production as well as efficiency and productivity.

10. There is non-leveraging of various incentives the are provided by the promotion of the *Investment Act 1986* and the *Income Tax Act 1967*.

According to the SMIDP's 2001–2005 study report (SMIDEC, 2002), SMEs in Malaysia are facing many new challenges, domestically as well as globally. These challenges include:

- intensified global competition
- competition from other producers (for example, China and India)
- limited capability to meet the challenges of market liberalisation and globalisation
- limited capacity for technology management and knowledge acquisition
- low productivity and quality output
- a 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
- the high cost of infrastructure
- a general lack of knowledge and information.

More recently, Ting (2004) highlighted many challenges that are still facing Malaysian SMEs. He identified five key challenges: 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 that SMEs will be wiped out if they do not increase their competitiveness in the new, rapidly changing world of globalisation.

More recently, UPS (2005) conducted a survey to determine the competitiveness issues faced by SMEs in selected 12 Asian countries. This study was based on more than 1,200 decision makers from Asian SMEs during 2004 in several countries (for example, Australia, China, India, Malaysia, among other Asian countries). The respondents were from a different range of industries, for example, automotives, garments and textiles, gifts and housewares, among others. One of the interesting findings of this study was that 73 per cent of the respondents considered Chinese SMEs to be more competitive than the SMEs in their own countries. The survey reported that the Philippines and Indonesian SMEs were ranked as the least competitive, while Malaysian SMEs came in tenth, and were considered competitive by 27 per cent of respondents. The survey also studied some of the obstacles to SMEs competitiveness across Asia. The results showed that innovation and access to market intelligence and other business information, and access to funding and capital, are the biggest challenges for SMEs across Asia. However, in the present study, a pilot survey of 100 Malaysian SMEs to determine the competitiveness issues they faced showed that labour cost, innovation and access to funding and working capital are the main challenges to Malaysian SMEs.

4. Conclusion and Some Policy Recommendations

This paper has examined and reviewed the extensive literature in regard to the development of Malaysian SMEs, their various contribution to the national economy, challenges they are facing and the initiatives and incentives offered by the government and its agencies.

The review indicates that Malaysian SMEs account for more than 90 per cent of the total manufacturing establishments in the country. The evidence suggests that SMEs play a vital role in the nation's economy and are a major source of various economic contributions. The largest number of concentration of SMEs is in the textile and apparel sector, followed by food and beverages, metals and metals products, and wood and wood products.

The key message from this study is that SMEs in Malaysia are facing domestic as well as external challenges, which could hinder their resilience and competitiveness. They include:

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

Having identified some of the challenges facing SMEs in Malaysia, we now present some strategies that the government and the agencies responsible for the development of SMEs in Malaysia (such as SMIDEC and MCA, among many others) — and SMEs themselves — may adopt.

First, 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 for 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. Therefore, the government 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 also 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 and so on). It should ensure that SMEs have access to 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 uptake and utilisation.

Regarding poor access to finance, even though the Malaysian Government has allocated funds under the Eight Malaysia Plan and delivered it through its agencies, there are many complaints by SMEs regarding the difficult qualification criteria for accessing these funds, and the bureaucracy in these agencies. Besides difficulties in meeting the requirements for these funds, SMEs also have difficulties because of transparency issues. However, there are some positive efforts on the part of the government in this regard, with the availability of CGC, in which the government guarantees loan applications by SMEs who are regarded as high-risk borrowers. However, for the CGC to be more effective, 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 to find their own path of progress by relying on strategies that allow them to access new markets, increase their revenue and expand their customer base. First, Malaysian SMEs facing challenges from a more integrated and liberalised world (for example, AFTA, ASEAN-China), 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, become more resilient and become stronger, in order to withstand domestic and foreign competitive onslaughts, as well as reap other benefits.

SMEs should consistently invest in market research, R&D and innovation in order to increase their competitiveness. By embarking on market intelligence, they should be better able to understand the needs and wants in the marketplace. Such understanding should assist in delivering superior value to customers, compared to what their competitors are able to do. This in turn will increase customer retention rate.

SMEs should leverage the advantages of being small by deploying relationship marketing strategies. The relatively small customer base of SMEs makes them more suitable for long-term customer relationships. By establishing long-term relationships with customers, they should be able to build customer loyalty, and in turn reduce cost of operations. 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.

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

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