

# **CHAPTER 1: INTRODUCTION**

## **1.1 INTRODUCTION**

In the early 1970s, the development of the Small and Medium Scale Enterprises become vital to the realisation of the twin objectives of eradicating poverty and restructuring of society under the New Economic Plan (NEP).

Thus it was stated in the Second Malaysia Plan (1971-1975) that :-

An important area of attention in the manufacturing sector will be the promotion of Small-scale Industries. Such industries can play a particularly useful role in Malaysia industrial development. Besides contributing to output growth in the sector, they can support and complement the activities of larger industries, particularly in supplying intermediate input requirements. They also facilitate the greater utilisation of domestic raw materials and contribute significantly to employment growth.

The government concern for SMIs has been clearly stated in all its Six Malaysia Plans (6MP,1991-1995). The objectives for SMIs development were originally outlined in the First Malaysia Plan (1966-1970). 6MP emphasis on improving the capability of SMIs to supply the required production inputs of the larger enterprises and also to penetrate exports markets. In the Second Outline Perspective Plan (1991-2000), SMIs being further promoted and upgraded, with the objective of making them an important and viable vehicle for industrial expansion and the creation of industry linkages and support.

Malaysia is now at a critical juncture in its economic and social development. In particular, our industrialisation has made such great strides that we do not think any more in terms of 'import substitution' or 'export orientation', but

rather how we could strengthen and diversify our industrial base through a concerted and accelerated development of SMIs especially during this recession time. SMIs, in conjunction with the ongoing investments by large scale industries , will lead to a well balanced, dynamic and competitive integrated industrial sector. It is timely therefore to review and discuss the supportive and complementary role of SMIs on deepening the structural base of the manufacturing sector.

## **1.2 DEFINITION OF SMIs**

In Malaysia, different government agencies have their own definitions of SMIs. The Co-ordinating Council for Development of Small-scale Industries (CCDSI) defines SMIs as one with fixed assets of less than RM250,000 or in the case of companies, with shareholders' funds not exceeding RM250,000. This definition was one of the most commonly adopted by organisation such as Majlis Amanah Rakyat (MARA), Credit Guarantee Corporation (CGC) and Bank Pembangunan Malaysia (BPM). However, BPM adopted different definitions for different loan schemes. For example, under its World Bank Scheme for SMIs, the equity limit for companies was RM750,000. In the case of CGC, while there was one definition of SMIs, the loan limit for bumiputra was RM200,000 and that of non-bumiputra was RM100,000.

The Industrial Co-ordinating Act (ICA) 1975 exempted a small enterprise from applying for a license if it had less than RM250,000 in shareholders' fund or

employed less than 25 full-time workers. This ceiling was revised upwards on 12 December 1985 to less than RM1 million in shareholders' funds or and employment of less than 50 full-time workers, and in 1987 to less than RM2.5 million in shareholders' fund or 75 full-time workers. Bank Negara Malaysia also revised its definition of SMIs in 1988 from enterprises with net assets or shareholders' funds of less than RM250,000 to registered business with net assets or shareholders' fund not exceeding RM500,000.

The Small Scale Industry Section in the Ministry of Trade and Industry (MITI) classifies as small-scale industry one which has shareholders' funds or assets not exceeding RM500,000 and medium-scale industry as one with funds or assets between RM0.5 million and RM2.5 million and employing between 20 and up to 99 full-time workers.

However, in 1998, the government has expanded the definition of SMIs in the manufacturing sector. Under the new definition, SMIs would be divided into two categories. The first is small-scale, encompassing companies with a maximum of 50 permanent employees and ranking in not more than RM10 million annually in sales. The second category is the medium-scale, with companies employing between 51 and 150 people and whose maximum annual sales is RM25 million (*Star* 19/1/98).

With the new definition, the government and the Small and Medium Scale Industry Development Corporation (SMIDEC) can continue to assist the SMIs.

This will also encourage them to expand their production, with the possibility of exporting the products to meet local and foreign demands.

### **1.3 IMPORTANCE OF SMIs**

The importance of SMIs have been emphasized under the Second Outline Perspective Plan (1991-2000) as well as the 6MP (1991-1995). Japan and Taiwan are good examples of countries in which SMIs contributed significantly to the growth of their manufacturing industries and hence to the economic success of their respective economies.

As Malaysia moves into the next phase of industrialisation during the coming decade, the SMIs will become increasingly important , not only as supportive and complementary structures, in a more dynamic and competitive industrial sector but more importantly as providing the feeder and technological linkages to ensure the successful development of the larger enterprises. For instance, the SMIs act as a catalyst for the growth of the national economy, thereby strengthening and widening the industrial base especially for the enhancement of export-led growth. The SMIs are widely recognized as an instrument for achieving balanced sectoral and regional development.

The government is therefore concerned about SMIs development. The objective with respect to SMIs was and still is, to develop local entrepreneurship, create productive employment, increase productivity and

incomes. This concern is nowhere better stated than by our Prime Minister in his paper, 'Malaysia: The Way Forward' :

Small and Medium scale industries have an important role to play in generating employment opportunities; in strengthening industrial linkages, in penetrating markets and generating export earnings. They have a crucial role as a spawning ground for the birth of tomorrow's entrepreneurs.

Lastly, SMIs also help in increasing the value-added of local commodities and resources, thus encouraging the diversification of production and from the raw materials stage to progressive manufacturing process.

#### **1.4 OBJECTIVE OF STUDY**

In order to attain the objective of becoming a fully developed industrialised nation by the year 2020, The Industrial Master Plan (IMP), (1996-2005), thus focus on enhancing value-added activities and increasing the productivity of the manufacturing sector. The SMIs are seen as an important development vehicle, not only in respect of their supportive and complementary roles to the large manufacturing establishment, but also diffusion of technology and promoting exports.

This study attempts to answer some very fundamental questions regarding SMIs. The objective of study are as follows :

- (1) To examine the contributions of SMIs in the economic development.
- (2) To discuss the future prospects of SMIs and the significant role of SMIs.

(3) To present a comprehensive and up-to-date picture of SMIs in Malaysia and some policy suggestions, so that the researchers and policymakers will have a clearer idea of the important role of SMIs in the general development of the Malaysian economy.

## **1.5 METHODOLOGY**

The analysis will be done through theoretical framework. The study will be presented in a comprehensive form with the aid of a variety of simple statistical and graphic techniques such as charts and tables. The study uses a collection of a number of published material relating to the agencies assisting SMIs. The purpose of this method is to gather the agencies' objectives and their role in promoting SMIs. This study also uses annual reports, such as reports from MITI, Bank Negara Malaysia and Ministry of Finance. Governmental and policy documents were also used in this study. Besides that, this research also refers to various books, journals and theses available.

## **1.6 ORGANISATION OF STUDY**

The study is divided into 5 chapters. Chapter 1 describes the importance of SMIs in social and economic developments. A brief review of the objectives and definitions is also included.

**Chapter 2 contains a literature review on SMIs and the Malaysian Economy. The literature review will draw out some of the important studies on the SMIs done by researchers.**

**Chapter 3 examine the roles of SMIs in Malaysia economy development in terms of employment creation, GDP and export growth, savings mobilisation, income distribution and fostering linkages between SMIs and large scale industries.**

**Chapter 4 discusses the problems encountered by SMIs and also the prospects of SMIs, including the government policies in promoting and upgrading the development of SMIs.**

**Chapter 5 is the conclusion of this study. Some policy recommendations is included in this section.**

## **CHAPTER 2: LITERATURE REVIEW**

### **2.1 OVERVIEW OF MALAYSIAN ECONOMY**

In the late 19<sup>th</sup> century, British colonial brought in immigrants for the expanding of colonial economy, especially Chinese and Indian. This resulted in Malaysia being a multiracial country, with Malays living in the rural areas and engage in agriculture and fishing, while the majority of the Chinese are in the urban areas where they dominate in commerce and most of the Indians live in the rubber and oil palm estates.

During the colonial period, the authorities, who generally considered the colonies as suppliers of raw materials and importers of manufactured goods, allowed only a few types of industry to develop. Most industries then were set up to reduce transport costs of exported or imported goods, such as factories for refining tin-ore and bottling imported drinks. Local industries developed most when economic relations with the colonial powers were weak (Jomo 1990). After Independence, the government encouraged industries to manufacture goods previously imported. As commented by Jomo (1990 p.12), "Most of these import-substituting industries were set up as subsidiaries of foreign companies to finish goods produced with imported materials for very profitable sale within the protected domestic market."

During the 1960s, Malaysia implemented the 'export-oriented industries' due to the advice from the foreign experts and international consultants which were encouraging the Malaysian government to switch to export-oriented industrialisation during that time. The Industrial Incentives Act was passed in 1968, while labour laws were amended in 1969 to help to create an investment climate more attractive to such industries. Together with other new incentives, free trade zones and other facilities were set up for this purpose.

Over the last three decades, the Malaysian economy has undergone tremendous structural changes, from a primary commodity producer into a highly diversified economy with a strong industrial base. This structural transformation is reflected in the composition of the country's Gross Domestic Products (GDP) as well as in the growth and composition of its manufactured exports.

After independence in 1957, the problems of poverty and uneven distribution of incomes remain serious. Furthermore, the incidence of poverty among Malays is disproportionately high. Their per capita incomes are only half of those of the Chinese and two-thirds of the national average. Since the poverty problem is large and persistent, the government has given top priority to its eradication. Apart from eradicating poverty, the Malaysian government is also interested in restructuring the economy in order to correct racial economic imbalance. In line with these twin objectives, the government formulated the two-pronged New Economic Policy (NEP) for development. The first prong of

the NEP is to reduce and eventually eradicate poverty by raising income levels and increasing employment opportunities for all Malaysians, irrespective of race. The second prong aims at accelerating the process of restructuring Malaysian society to correct economic imbalance so as to reduce and eventually eliminate the identification of race with economic function. This process involves the modernisation of rural life, a rapid and balanced growth of urban activities and the creation of Malay commercial and industrial community in all categories and at all levels of operation so that Malays and other indigenous people will become full partners in all aspects of the economic life of the nation (Chee, 1986).

Since independence in 1957 until 1980, the Malaysian economy expanded at a higher rate, reflecting the impact of the government's programme to develop the economy through a sustained programme to diversify and modernize agriculture and promote industrial development, including SMIs. During 1976 through 1980, that is during the Third Malaysia Plan period, real Gross Domestic Product (GDP) grew by 8.5 per cent per annum with domestic demand rising rapidly following the 'export-boom'. This period saw the rapid development and build-up of the country's infrastructure. Malaysia since 1970s has achieved an economic growth rate over 7 per cent, making it one of the fastest growing economies in Asia. Malaysia is the world largest exporter of natural rubber, crude oil, tin and a major producer of tropical hardwood, petroleum and natural gas. In the 1980s, Malaysia emerged as a significant

exporter of manufactured goods. It is the world's largest exporter of electronic integrated circuits and components (Fong 1986).

However, partly as a result of the international recession and partly due to structural developments, the Malaysian economy expanded at a slower rate during the early 1980s. Nevertheless, per capita income continued to increase through 1984, as the counter-cyclical economic policies pursued by the government in the early 1980s enabled national income to increase at a faster rate than the rate of population expansion (Lim *et al.* 1989). A feature of the Malaysian experience in economic development since independence was that rapid economic growth was achieved with price stability. Consequently, with increases in nominal per capita income continuing to outstrip price increases, Malaysians generally enjoyed improved standards of living and prosperity.

As a result of the severe international recession during the last decade, coupled with structural weaknesses of the economy that emerged after the early 1980s, real GDP declined by 1 per cent in 1985 and only grew by 1.2 per cent in 1986. The low level of output growth coupled with a severe deterioration in the terms of trade led to sharp declines in per capita income of Malaysians in 1985 and 1986. Nevertheless, as a result of the structural adjustment measures undertaken by the government as well as the private sector, particularly to promote the competitiveness of the export sector, the Malaysia economy recovered in 1987 with real growth of about 2 per cent and Malaysians are expected to recover some of the losses in per capita income

experienced during 1985-86. In 1991-95, the economic growth reaches 8.84 per cent while the economic growth for the year 1995 was recorded 9.62 per cent. As a whole the economic growth for the period 1980-95 was recorded 6.9 per cent. The per capita which was RM3650 in 1980, increased to RM10,068 at the end of 1995 with an annual growth of 7.63% during the same period.

The vision of the nation is to attain the status of a fully developed nation by 2020. In order to achieve this, government has taken some steps by further diversifying the agricultural and industrial sectors of the country. Therefore, there is a large investment opportunities for both domestic and foreign investors in Malaysia due to the diversified agricultural sector and rapidly growing manufacturing sector. At this stage, Malaysia experiences a labour shortage due to the rapid industrial development. The government thus emphasis on productivity-driven growth initiatives. This strategies has been accordingly emphasised in the Seventh Malaysia Plan (7MP) and Second Industrial Master Plan (IMP2).

According to Fong (1986), in the past the industrial development had followed different stages. First was the energy development program to extract vast reserves. Second stage was the development of petrochemical projects in Terengganu to produce chemical raw material using natural gas as feed back. Next come the heavy industries such as the Terengganu integrated steel mill and the national car industry. Due to the establishment of these heavy

industries it paved way for light and medium industries producing components and parts for both domestic and world markets. At the end, a whole range of industrial activities were based on wood, palm oil and rubber were development to further deepen the Malaysian economy.

Over the last three decades, the Malaysian economy has undergone tremendous structural changes, from a primary commodity producer into a highly diversified economy with a strong industrial base. This structural transformation is reflected in the composition of the country's Gross Domestic Products (GDP) as well as in the growth and composition of its manufactured exports.

In 1957, the agriculture sector contributed 5.75 per cent to the total GDP, 61.3 per cent of total employment and more than 80 per cent of the country's exports; whilst the manufacturing sector contributed about 8 per cent to GDP and 6.4 per cent to total employment. For the next two decades, the manufacturing sector grew rapidly and by 1990, its contribution to GDP and total employment increased to 27.0 per cent and 19.5 per cent respectively. In the same period, exports of manufactured products rose to RM 47.7 billion or 52.7 per cent of total country's merchandise exports. In 1995, the total manufacturing output amounted to RM 39.9 billion or 33.1 per cent of GDP.

It is expected that growth in the Seventh Malaysia Plan (1996-2000) will continue to originate primarily from the manufacturing sector. During the

Seventh Malaysia Plan period, the manufacturing sector is projected to bring an investments of RM110 billion, contributing to about 37.2 per cent to GDP and accounting for about 88.6 per cent of total merchandise exports earnings by the year 2000.

**Table 2.1: Performance of the Manufacturing Sector 1970, 1990, 1995 and targets for 2000**

	1970	1990	1995	2000
<b>Output</b>				
(i) In RM million *	2,995	21,381	39,825	58,010
(ii) As % Share of GDP	13.9%	27.0%	33.1%	37.2%
<b>Employment</b>				
(i) In number	295,452	1,290,200	2,051,600	2,143,900
(ii) As % Share of GDP	8.7%	19.5%	25.2%	23.9%
<b>Exports</b>				
(i) In RM million **	614	48,047	147,524	209,250
(ii) As % Share of GDP	11.9%	60.4%	79.6%	81.8%

\* 1978 Constant Prices

\*\* Current Prices

Source: 1. Economic Report (various issues), Ministry of Finance

2. Second Outline Perspective Plan

The manufacturing sector has played an increasingly important role in the economic development of the country. This was achieved through rapid and accelerated private sector participation and the development of more efficient and dynamic export-oriented industries.

Now Malaysia is entering a new phase of development. The Sixth Economic Development Plan which kicked off in 1991 has identified accelerated industrial development as crucial to the continued rapid expansion of the economy and to provide a basis for meeting the social objectives consistent with the New Economic Policy (NEP). It will also build up the foundation for

leap-frogging towards an advanced industrial country in the information age, by increasing indigenous technological capability and competitiveness.

This strategy was further emphasised with the launching of Malaysian Industrial Development Authority's (MIDA) Industrial Master Plan (IMP) which provides the general industrial development objectives and framework of development strategies for the period 1986 - 1995.

Studies under the IMP identified the manufacturing sector as the engine of growth in the 1990s for Malaysia to achieve and sustain high economic growth. More specifically, the industrialisation strategy will involve the intensive development of resource-based industries for export, and the diversification and upgrading of non resource-based industries as well. Under the Second Outline Perspective Plan (OPP2) 1991 - 2000, Malaysia's GDP is targeted to grow at 7 percent in real terms during the OPP2 period. The manufacturing sector is expected to continue its role as the engine of growth in the nation's economic growth during the IMP2 period (1996-2005). Contribution of the manufacturing sector to GDP will reach 37.5 percent by year 2000 (38.4 percent by year 2005) from 33.1 percent in 1996.

Expected growth rate for the sector is 10.7 percent per annum for the first half (1996-2000), and 8.3 percent per annum during the second half (2001-2005) of the Plan period (refer table 2.1).

Some Asian countries have experienced manufacturing share to GDP of more than 30 percent, such as in the case of Taiwan which had a share of 38.2 percent in 1985, but has since gone down to 30 percent. Malaysia's figure of 38.4 percent by year 2005 is forecasted to be higher than the peak of 38.2 percent experienced by Taiwan in 1985.

**Table 2.2: MALAYSIA- Forecast of Sectoral Value-Added Shares**

Sectors	Share of GDP (%)			Average Annual Growth Rate (%)	
	1995	2000	2005*	1996-2000	2001-2005*
Services (Including Public Sector)	44.3	45.8	48.4	8.8	8.9
Manufacturing	33.1	37.5	38.4	10.7	8.3
Agriculture	13.5	10.5	8.2	2.6	2.5
Mining	7.4	5.7	4.2	2.3	1.5
Construction	4.5	4.8	4.7	9.7	7.3
	100.0	100.0	100.0	8.04	7.7

Source: 1. \*Second IMP (1996-2005), MITI

2. Economic Report (various issues), Ministry of Finance

## **2.2 OVERVIEW OF SMIs IN MALAYSIA**

Since the late 1980's, small and medium industries in Malaysia have made significant contribution to the growth and expansion of our industrial sector and to the economy as a whole. This was clearly stated in all the Seven Malaysia Plans that incorporate SMIs as an important component in the growth and development of the industrial sector recently. In 1981, small and medium scale industries accounted for about 97.7 per cent of manufacturing establishments (small 1990). Despite their numerical preponderance, SMIs accounted for a relatively small proportion of total employment and the value

added for all manufacturing establishments. Nevertheless, in the current attempt to accelerate the growth of the modern industrialised sector, greater emphasis is being placed on the development of SMIs.

Despite its importance, very few studies have been done on this topic. *'Measures for the Development of Small-scale Industries in the Federation of Malaya'* studied by Stepanek's was undertaken in 1960 and was based on figures which were obtained much earlier on. In any case, the study contained very little data since no field study was undertaken.

In 1969, *'Study of the Small-scale Industries in Malaysia'* by L. Munjal was based on a visit to about 50 factories in Johor, Pahang, Kelantan and Perak. In addition, completed questionnaires were received from another 70 small-scale enterprises from all over the country. Unfortunately, the data from the survey were not tabulated. The report amounted to little more than general observations of the problems of small industry in Malaysia.

*'Small Business in Japan's Economic Progress'*, by Yamanaka, Tokutaro (1971) is an old publication but contains an information regarding the role of SMIs in the economic development of Japan in first half of this century. The study also gives a comparison of SMIs in Japan and USA. The author tried to study the impact of small businesses on different economic factors like GDP, export and employment. He also studied the problems faced by small

businesses in Japan, such as lack of credits, technological problems, marketing and etc.

There were some studies done by Chee Peng Lim. His study on '*The Role of Small Industry in the Malaysian Economy*' is a Ph.D dissertation submitted to the University of Malaya in 1975 and contains analysis of data prior to 1975. Chee *et al*'s study (1979) focuses on small entrepreneurs and entrepreneurial development programmes in Malaysia. While in 1986, his research on small industries in Malaysia is base on data during the period 1961-83. It shows the importance role of small industry in Malaysian economy. It also discusses the problems faced by small industry, government policy towards small industry, assistance programs and future of the small industry.

The World Bank's study (1982) tries to identify the main problems facing small enterprises and suggests changes in the policy environment and institutional set-up which attempts to resolve these problems. The study contains useful data on small industry but is confidential and thus not available to the public.

Finally, more recent serious study on SMIs was done by Ismail Salleh (1990). Basically, the study examines the problems and prospects of SMIs. In his study, Ismail discusses the structure of Malaysian SMIs and their significant role to Malaysian economic growth. The research also compares the

**contribution of Malaysian SMIs with those in the Philippines, South Korea and Japan. Besides, problems and government policy towards SMIs are also included.**