

## CHAPTER 6

### SUMMARY OF FINDINGS, CONCLUSIONS, AND RECOMMENDATIONS

The crucial role played by small and medium scale industries in Malaysia's industrialisation process has been clearly stated in the Sixth and Seventh Malaysia Plan, as well as the Second Industrial Master Plan (IMP). Their growth potential could be speeded up by various government policies that are specifically designed to cater for their business needs. Under the Second IMP's "plus-plus" approach, SMIs must be developed into key suppliers of components or inputs, as well as services for large industries and MNCs. Moreover, SMIs must prepare themselves to compete in the fast pace of liberalisation under the rules of World Trade Organisation, which has already caused concern among developing countries as many of them are still not ready to open up their economies to foreign competition.

#### 6.1 FINDINGS AND CONCLUSIONS

According to Schumpeter, the role of entrepreneur is the key figure in economic development. He felt that the economy was pushed forward in sudden leaps by the activities of key men who wanted to promote new goods and new methods of production, or to exploit new sources of materials or new markets. Schumpeter distinguished five types of innovation: (1) developing new products or services that is an improvement in the quality of an existing one, (2) introducing new methods of production that increase productivity, (3) identifying new markets, in particular penetration of new territories and foreign markets, (4) discovering new sources of supply of raw materials or intermediate manufactured goods, and (5) creating new forms of organisations, such as the creation or the breaking up of a monopoly position.

Various policies that are designed to promote SMIs have almost the same characteristics as Schumpeter's first three types of innovation. For the first and second type, SMIs were told to improve quality as well as their productivity to enhance competitiveness, both in the domestic and international markets. The government has also taken various initiatives to provide adequate training programmes, research and development as well as relevant advisory services such as Product Development and Design Scheme (ITAF 2), and Quality and Productivity

Improvement Scheme (ITAF 3) to enable SMIs to increase productivity. As for the third type, the government has launched various market promotion programmes such as Export Credit Refinancing Scheme, Double Deduction of Expenses for Promotion of Exports, and Market Development Scheme (ITAF 4) to enable SMIs to export their products and build up export marketing expertise.

Ministry of Entrepreneur Development was formed on 8 May, 1995 to assume full responsibilities over the functions of Ministry of Public Enterprise which was abolished on 7 May, 1995. To achieve the Government's vision of a resilient bumiputera commercial and industrial community (BCIC), the Ministry of Entrepreneur Development has the mission of creating and developing genuine entrepreneurs who will be of quality, are resilient, successful and competitive in all the growth sectors of potential in the economy and to cultivate an entrepreneurial culture among Malaysians.<sup>1</sup> On 2 August 1995, the implementation of Vendor Development Programme was taken over by the Ministry of Entrepreneur Development. Moreover, the recent establishment of SMIDEC, a single agency to promote and accelerate the development of SMIs, shows the recognition of the important role SMIs can play in the socio-economic growth. The function of the SMIDEC comprise promotion and advisory services as follows:-

- A. Undertake promotional activities and provide advisory services on SMI programmes as follows:-
  - (a) subcontract exchange; (b) umbrella concept; (c) market promotion; (d) market surveys; (e) development programme for industrial sites; (f) financial assistance; (g) technical fund for small scale industries; (h) workshop for SMI/business clinic; and (i) promotion through electronic and print media.
- B. Coordinate technical aid and financial assistance through:-
  - (a) assist in the coordination of technical programmes including those from international bodies; (b) assist in the modernisation and upgrading of SMI capabilities through financial assistance programmes; and (c) establish joint venture between Malaysian and foreign SMI's.
- C. Coordinate development programmes of SMI's through:-
  - (a) cooperation with large companies (MNC's) to create and encourage linkages with SMIs; (b) financial and technical assistance with the cooperation of

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<sup>1</sup> Ministry of Entrepreneur Development's homepage, internet.

relevant institutions to uplift the capabilities of SMIs; (c) assist in the planning and identification of SMI Industrial sites with cooperation from MIEL and state governments.

- D. Collect and establish a computerised information network with SMI centres in the state and federal offices.<sup>2</sup>

Recently, SMIDEC had signed several agreements with three companies in automotive industry, three banks and University Technology Malaysia to intensify research and development for SMIs. The agreement will see collaboration efforts between SMIDEC and UTM's business advanced technology centre in developing and strengthening the technical and technological foundation of SMIs.

This study shows that majority of the firms are registered as limited corporations as compared to findings by MITI which showed only 38 percent. This research also shows that 67 percent of the firms have paid up capital below RM500,000 while findings by MITI showed that more than 80 percent of the SMIs have the same amount of paid up capital. Majority of the firms have annual turnover above RM1 million, which is contrary to the findings by MITI that showed majority of the SMIs had turnover below RM500,000. Contrary to the findings by MITI in 1993/1994 which indicated that 51 percent of total SMIs employed between five to ten workers and only five percent employed between 60-75 workers, results in Table 4.1 shows that majority of the SMIs employed above 20 employees. These variations could probably be due to this research which only covers the urban area in the Klang Valley, hence have relatively higher percentage of establishments registered as limited companies, thus required higher amount of paid-up capital, higher turnover, as well as more employees.

As for ownership equity, nearly 90 percent of the SMIs are owned by local entrepreneurs, is consistent with the findings in the Sixth Malaysia Plan that most of the SMIs are owned by local entrepreneurs. However, as for marketing aspects, results in this study indicated that only 16.5 percent of the SMIs exported their products overseas, as compared to 20 percent reported by MITI. This research shows that about 32 percent of the medium scale industries and nine percent of the small scale industries exported their products overseas, which is contrary to the

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<sup>2</sup> Ministry of International Trade and Industry, MITI's homepage, internet.

findings by the census, which identified 47 percent of the medium scale industries and 15 percent of the small scale industries exported their products. This variation could partly be attributed to lesser coverage on SMIs that are engaged in chemical, petrol, and rubber industry. These industries had the highest percentage of their products exported (34 percent) as reported by the SMI Census and Study 1993/1994 conducted by MITI.

In terms of incentives for investment, results in this study indicated that majority of the firms did not utilise most of them. However, most of the firms were aware of the availability of such incentives. This finding is contrary to the findings by Bank Negara Malaysia in 1995 which showed that majority of the SMIs were unaware of such incentives. Various reasons were given by SMIs for not utilising them. These include being disqualified, unaware of procedures, unknown source of incentives, do not need such or incentives, application still in the process, etc. As for utilisation of such incentives, this research is consistent with BNM's findings that there is still a low level of utilisation of these incentives by SMIs.

As for financial and credit facilities, the utilisation rate is relatively much higher in this study as compared to others. This study shows that about 49 percent of the SMIs have access to financial and credit facilities which is consistent with the findings by Pazim @ Fadzim Othman and Mohd. Rosli Mohamad (1995) that 40.3 percent of the SMIs have been granted loans. However, this finding contradicts that of BNM's (1995), which reported that only six percent of the SMIs have access to financial and credit facilities, while none of the respondents enjoyed ITAF scheme, and only 6 percent utilised facilities offered by CGC. This situation could partly be attributed to SMIs in this study were located in urban areas, hence entrepreneurs have better access to information on various financial and credit facilities as compared to rural entrepreneurs. This situation is further supported by the fact that 63 percent of the total approved ITAF scheme applications are located in Selangor and Kuala Lumpur.

As for marketing programmes and facilities, results indicate that only 1.5 to 16.4 percent of the SMIs utilised 11 out of 12 of the facilities provided by MITI and MATRADE (Table 4.18). As for Vendor Development Programme, BNM (1995) reported that only 8 percent of the SMIs utilised this programme while only 11

percent were aware of it as compared to 16 and 42 percent respectively in this study. As for sub-contracting, the findings in this research is much less than that by BNM, which shows that 14 percent of the SMIs undertake sub-contracting jobs (only 7.5 percent in this study).

Results in this study also indicate that majority of the SMIs did not utilise infrastructure facilities. Only 18 percent and 34 percent of the SMIs utilised industrial land/estates and ready-built factories respectively. This is consistent with the finding by MITI which reported that 46 percent of the SMIs operated their businesses in their own building, of which 69 percent of the medium scale industries and 26 percent of the small scale industries were sited at industrial land. This could partly be attributed to SMIs (especially small scale industries) in the Klang Valley found that prices of land and premises were unaffordable, hence they had to rent premises to run their businesses. This was agreed by two-third of the SMIs (see Table 4.25).

In terms of training facilities and advisory services, there is a high level of utilisation especially on services provided by local institutions, while the opposite for facilities provided by foreign institutions (two out of seven institutions). Hence, this is consistent with the findings in Chapter 2 that many SMIs still dependent highly on the effort of governmental organisations for research and development.

Various problems faced by SMIs are also examined in this research. Among the most serious problems are labour shortages, inadequate access to market information and inflationary pressure. More than 80 percent of the SMIs admitted facing labour shortages as well as inadequate access to skill labour. This is consistent with the findings by Shinichi Saito (1996) that 68.9 percent of the respondents ranked labour shortages as their major problem. This situation worsened as the unemployment rate declined further from 2.9 percent in 1994 to 2.8 percent in 1995. This further contributed towards high labour turnover and upward pressure on wages. Hence, SMIs have no alternative but to resort to foreign labour. This research also shows that foreign labour comprised more than 20 percent of the SMIs total labour force (the proportion in this study is double compared with the findings by MITI in 1993). Inadequate access to skilled labour was also admitted by the International Trade and Industry Minister Datuk Seri Rafidah Aziz who stated that

we still need foreign skilled labour until the country's training institutions could supply adequate skilled labour of its own.

Other serious human resources/managerial problems were competition with other business counterparts in getting skilled labour, high labour turnover, and lack of experienced managerial staff. All these problems are inter-related. The decline of unemployment rate further contribute towards high labour turnover, hence SMIs need to compete with other business counterparts in order to have enough manpower resulting in staff-pinching. This leads to an upward pressure on wages (agreed by 76 percent of the SMIs). This is consistent with the findings by Shinichi Saito (1996) that 54.7 percent of the respondents agreed that rise in wages as their major problem. Increasing cost of raw materials was another major problem faced by SMIs. This could probably due to high imports of intermediate goods. Moreover, shortage of local raw materials also contributed towards SMIs to source for imported raw materials.

Findings in Table 4.26 show that firms which intended to export their products reported that they have inadequate access to overseas marketing information. This resulted in SMIs emphasising more on securing domestic market share rather than penetrating into markets overseas. This finding corresponds with MITI's findings that only 20 percent of all the SMIs exported their products. Hence, results in Table 4.31 show that about 48 percent of the firms reported that market promotion programmes were insufficient to cater for their business needs while another 33 percent needed more assistance with regard to these programmes and facilities to enable them to expand their market.

Other major problems faced by majority of the SMIs were lack of experienced managerial staff, high labour turnover, increasing wages and salaries, high cost of borrowings, unaffordable price of land and other fixed assets, unable to acquire discounted rates on purchase of machinery, high cost of training and development of employees, high cost of research and development, high rental costs, lack of experienced sales personnel, lack of knowledge on overseas marketing opportunity, shortage of capital to launch aggressive marketing strategy, time consumption in application for facilities provided by the government, need to interact with inefficient/unfriendly governmental staff, unaware as well as inadequate access to

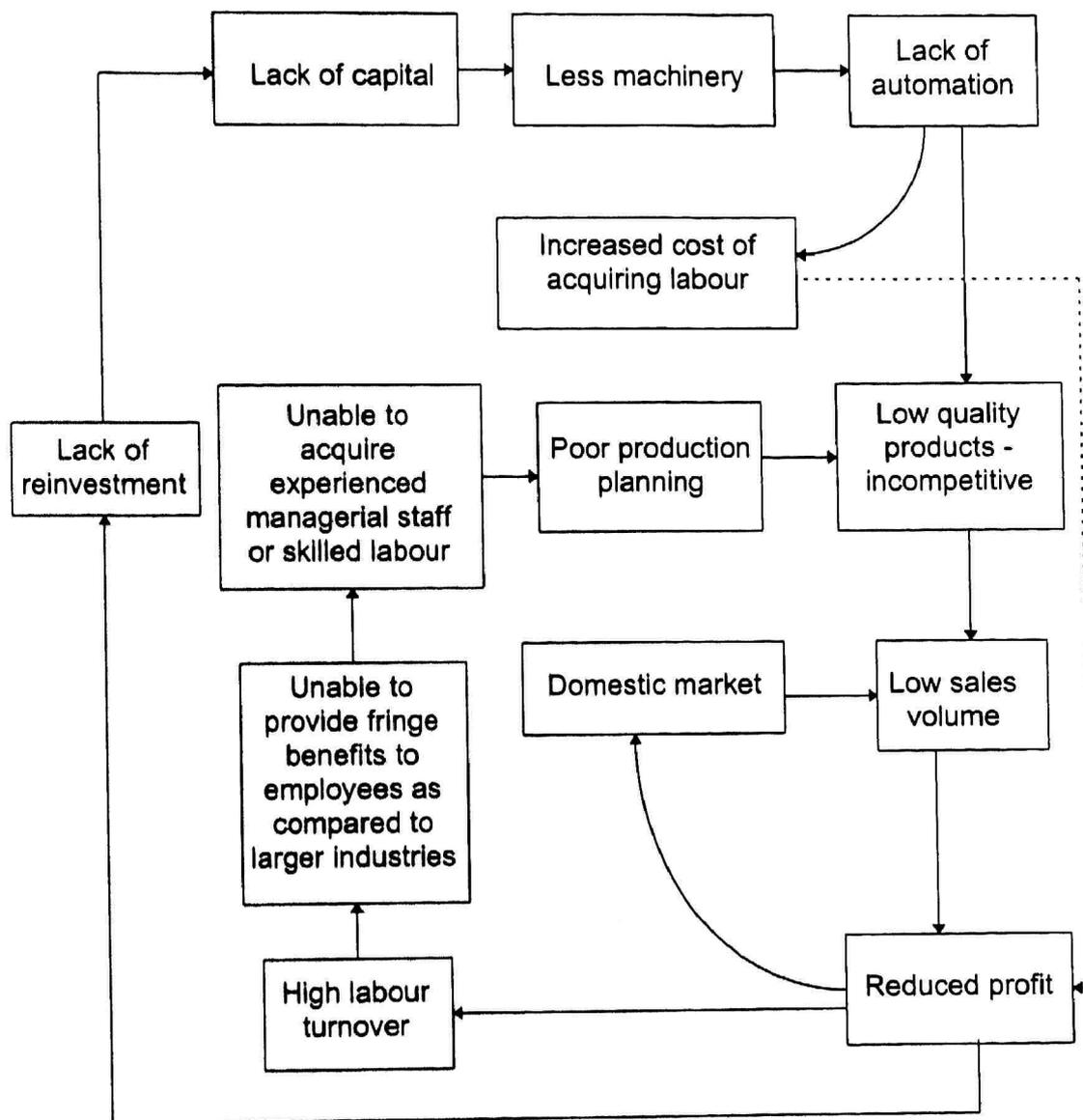
relevant advisory services, and lack of linkages among business counterparts. These problems have hindered the development of SMIs.

Moreover, these problems are usually inter-related. Many of the SMIs are still operating as backyard industries, without proper premises and facilities. This could hindered them from providing collateral required when applying for loans. Inadequate access to loans further inhibit them to expand. Hence, they were unable to acquire needed machinery and technology to produce quality products, hence reduce their competitiveness. This could further contribute towards lower sales volume, hence lower profit margin and cash flow problems. Therefore, they were unable to provide fringe benefit to their employees as compared to other larger business counterparts, which could ultimately lead to shortage of labour as well as high labour turnover. Shortage of experienced managerial staff could further lead to poor production planning and production, which further reduce their competitiveness. This is a cyclic problem, where one problem can lead towards other problems (see Figure 6.1). Therefore, it is important for a governmental intervention to design policies which could reduce the problems faced by SMIs to some extent.

It is also worth noting that negative perception on various programmes and facilities provided outweigh the positive ones. The perception of SMIs on various programmes and facilities shows that they needed more assistance with regard to relevant facilities. Hence, some of the firms reported that these facilities were insufficient to cater for their business needs, thus they needed more relevant assistance with regard to these programmes and facilities.

Results from Table 5.1 indicates that there is a significant relationship between size of firms and utilisation of incentives for investment. This shows that small scale industries are more unlikely to utilise incentives for investment. On the contrary, the medium scale industries are more likely to use at least some of the incentives for investment. This might probably be due to larger capital investment by medium scale industries which have been greatly encouraged by MITI as compared to small scale industries. Moreover, medium scale industries tend to have higher opportunity for reinvestment as compared to small industries. Hence, medium scale industries have greater access to enjoy incentives for investment.

Figure 6.1: Problems Faced by SMIs



Source: Constructed from survey.

In terms of financial and credit facilities, medium scale industries are more likely to utilise at least some as compared to small scale industries. This could probably be due to smaller amount of paid-up capital or shareholders' funds as well as equity of small scale industries, resulting in inability to provide collateral required and guarantor which is necessary for most of the borrowings by banks and finance companies. Moreover, most of the banks find that lending to small scale industries encounter higher risks compared to medium scale industries. Banks also finds that small loans also need almost the same amount of time and effort to process as the

bigger loans. Hence, banks and finance companies are more reluctant to offer loans to small scale industries as compared to medium scale industries that can afford to service their loans with interest.

Results show that there is a significant association between size of firms and utilisation of training facilities and advisory services. Medium scale industries are more likely to enjoy training programmes and advisory services, while small scale industries are more unlikely to enjoy them. This might be due to the fact that medium scale industries tend to be engaged in capital intensive productive capacity which requires more trained and skilled labour force as compared to small scale industries which require less skilled workers. Hence, there is a high tendency for medium scale industries to send their employees for training as compared to small scale industries. Moreover, medium scale industries have greater opportunity for reinvestment and expansion as compared to small scale industries, thus need more advisory services to enable them to reinvest in more productive activities. Medium scale industries also tend to have larger market coverage, and some of them even export their products overseas. Therefore, they need adequate access to advisory services pertaining to market information and overseas marketing opportunity to enable them to export their products. On the contrary, small scale industries tend to have smaller market coverage and mainly focused on domestic market, thus do not need as much advisory services pertaining to market information and opportunity.

Another area that shows significant association is that small scale industries are more likely to be labour intensive than medium scale industries. This corresponds with the finding in Table 2.2 that medium scale industries are more capital intensive. This could be attributed to larger capital investment in the case of medium scale industries which enable them to purchase more machinery as compared to small scale industries that have smaller capital investment.

Small scale industries are known to be unable to provide collateral required. Small scale industries have smaller amounts of paid-up capital or shareholders' funds, as well as equity, causing them to face problems when borrowing from banks that required adequate collateral as part of the requirement to qualify for loans. This could partly be attributed to the size of their businesses, where they could hardly expand their production capacity, thus limit their size of market coverage. Therefore,

they could rather save their profit than to reinvest them because they might find that reinvestment encounters higher risks. Small scale industries also agree that they face the problem of high rental costs. This could probably due to the fact that many of them could not afford a factory, especially in the Klang Valley where prices of premises were unaffordable by small scale industries. These three are part of other serious problems that could have hindered the development and expansion of small scale industries as compared to medium scale industries, thus many of them consequently remain small.

Smaller firms need to spend more time in applying facilities provided by the government (see Table 5.9). This corresponds with earlier findings that smaller firms had lesser access to some of the facilities and incentives provided. This could partly be attributed to many of them still operating as backyard industries, and some of them even without approval from the authorities. Moreover, they tend to have smaller capital investment as well as lesser reinvestment opportunity (corresponds with finding in Table 5.7), hence it is difficult for them to qualify for facilities provided by the government despite the amount of time spent on applications for some of the incentives and facilities.

Results also show that there is a significant association between size of firms and problems of inability to meet deadlines and inadequate automation (see Table 5.10). Problem such as inability to meet deadlines is very much related to inadequate automation which is agreed by small scale industries. As discussed earlier in Table 5.2 and Table 5.7, small scale industries have less access to financial and credit facilities as well as inability to provide collateral required. Hence, they have inadequate capital to purchase required machinery to increase their production capacity and productivity, thus contribute towards inability to meet deadlines.

Findings in Table 5.12 indicates a significant association between size of firms and location of the firms, where the factories of small scale industries tend to locate at non-strategic location as compared to medium scale industries that have better and more strategic location. As discussed earlier, many small scale industries are still operating as backyard industries, lack of proper premises and facilities, especially infrastructure facilities. Some of them operate in areas and promises that

are not designed for industrial purposes. Therefore, such locations are normally not strategic as compared to businesses that operate in industrial zones.

## 6.2 RECOMMENDATIONS

One of the major shortcomings in research involving private sector participation in most of the SMIs is their reluctance to disclose information about their businesses despite being assured that this type of research is purely of academic interest only. SMIs should give support pertaining to this type of studies to ensure that their problems can be passed to relevant authority, hence to formulate or improve on existing policies to reduce those problems. Furthermore, they can also suggest ways to improve various support facilities so that action can be taken to improve on them.

Being aware of the various problems as stated above, the government has to take several measures in curbing these problems to ensure the success of the efforts in developing SMIs. There were some useful recommendations by the respondents. Most of the recommendations are pertaining to improving the present marketing programmes. For example, government should give opportunity to SMIs to ensure there are "captive markets" for their products. One of the respondents suggested that the government can also reduce or abolish some of the sales tax which burden the SMIs especially those with low sales turnover. This could be done through reducing procedures required as well as qualifications in application for sales tax exemption especially for small scale industries. It has also been suggested that anchor companies could help vendors to venture into new markets.

Financial support should be improved and strengthened to cater to the needs of this sector, especially for heavy capital investment industries such as the electronic industry. Some of the respondents recommended that the present financial and credit facilities should be more sensitive towards the needs of heavy capital investment industries. Moreover, a comprehensive guideline on loans to SMIs should be formulated. Banks and financial institutions should provide SMIs with greater accessibility to loans based on the assessment of the viability of their projects rather than merely insisting on collateral especially with the CGC.

Another area that should be given emphasis are in strengthening the inter-industry linkages. Sub-contracting provides a useful mechanism for developing linkages between SMIs and large scale enterprises. However, poor quality of products, lack of necessity for sub-contracting because of sufficient self-production capacity on the part of the large firms, delay in delivery, shortage of suitable qualified small firms, low technology and managerial skills as well as instability of the management of SMIs have been identified as the main factors for the lack of linkages between SMIs and large scale industries or MNCs. Hence, some of the respondents have suggested that more fund for R&D, training of employees should be allocated to SMIs, as well as to provide more technical services relating to improvements of products.

According to Paul Low Seng Kuan<sup>3</sup>, specific measures should be taken by the government to develop the linkages between the SMIs and larger industries or multinational corporations:

- a) Specific investment incentives such as those given to encourage companies to use local components must be tailored to promote linkages;
- b) Selective tariff measures to discourage importation of foreign components and, at the same time, encourage backward linkages;
- c) Policy to increase local content should be continued to encourage the sourcing of raw materials and components from domestic industries;

The Government Purchasing Scheme should be continued to provide business opportunities to the SMIs.

Moreover, assistance should be made available to SMIs in order to assist them to penetrate foreign markets. For this purpose, foreign marketing agents should be engaged to provide the necessary and timely information, contacts and the latest standard requirements so that products can be tailored to the market needs. Other strategies such as upgrading the level of skills among the SMI employees, technology and management capacity as well as providing a comprehensive and integrated plan for the promotion and development SMIs should be considered. Some of the respondents have also suggested that government should publicise various policies, incentives and programmes to promote SMIs to enable SMIs to

obtain latest information pertaining to these programmes. Some respondents have even quoted "How to go about obtaining such facilities?", "We are not sure whether we are entitled to apply for the facilities, and we are most grateful if the government can provide more information on them", "Reduce procedures and simplify regulations pertaining to investment incentives", "Red-tape should be reduced in matters pertaining to various programmes and facilities", and "The government should provide more information pertaining to various promotional programmes and facilities".

Finally, there is a need for the government to develop a policy to make it mandatory for all SMIs to register under one body, such as under SMIDEC, MITI, MED, or FMM. This is for the benefit of all parties, where both parties are able to provide information in both ways. This can provide SMIs with timely and needy information pertaining to various new policies, programmes and facilities that are available.

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<sup>3</sup> Paul Low Seng Kuan, "The Manufacturing Sector: Problems, Issues and Policies." in Teh Hoe Yoke and Goh Kim Leng (eds.) (1992), Malaysia's Economic Vision: Issues and Challenges, Petaling Jaya: Pelanduk Publications, p. 208.