

CHAPTER ONE: INTRODUCTION

1.1 THE DEFINITION OF SMES

Small and medium sized industries and enterprises is the backbone of the Malaysian economy and contributed significantly to economic development in the forms of employment generation, income distribution and increase domestic value added. According to SMI Development Plan, as at 1996, SMEs accounted for 93.8 per cent of all establishments in the manufacturing sector and contributed 27.3% to manufacturing output; 25.8% to value-added; 27.6% of fixed assets; and 38.9% of employment).

Both of the industries and enterprises are generally referred to as **SMEs** (small and medium size entrepreneurs).

In his doctorate thesis in 1975, Chee Peng Lim has indicated that the different definitions by various government agencies have caused some difficulties in assisting the SME sector (Chee Peng Lim, 1975).

It was not until the later part of 2001 that SMIDEC and MITI (Ministry of International Trade and Industry) have made the definitions of SMIs and SMEs homogenous, whereby SMEs now denotes small and medium entrepreneurs. SMEs are defined by them as industries and entrepreneurs/ enterprises with an **annual sales turnover** of not exceeding RM25 million and employ less than 150 **full time employees**.

There is no universally accepted definition of an SME. The definitions used vary widely among countries, but are usually based on employment.

The employment criterion was chosen by Chee Peng Lim (1975) "because the 'Directory of Manufacturing Establishments' which contain the most up-to-date list of manufacturing establishments available at the time of study, classifies the establishments according to full time employment only....However, the size of an establishment can be represented by other quantitative measures such as sales, output, installed horsepower and capital stock."

He further justified that "The definition adopted should be based on two different sets of criteria. For planning purposes, the number of employees should be the deciding factor. For programmes of techniques and financial assistance, other criteria may be required, particularly capital, defined as fixed assets."

Realising the intensified international trading activities and more liberalised and globalised business environment, we need to also understand other countries' definitions of SME.

For **European Union (EU)**, the definition of an SME is summarised in the table below. "It must be applied in all Community or national programmes concerning them. Although use of the definition of an SME is gradually becoming widespread, not all the criteria are yet systematically applied. Consequently, greater discipline is required regarding application of the Community definition of an SME." (The Commission of European Committee, 2001)

The EU defines SMEs as having fewer than 250 employees:

DEFINITION OF A SMALL AND MEDIUM-SIZED ENTERPRISE (SME)			
Criteria	Micro-enterprise	Small	Medium
Number of employees	≤ 10	≤ 50	≤ 250
Annual turnover or total balance sheet	---	≤ € 7 m ≤ € 5 m	≤ € 40 m ≤ € 27 m
Independence	---	No more than 25 % of the capital or voting rights held by one or more enterprises which are not themselves SMEs	

On the other hand, **The World Bank Group** ' s Small and Medium Enterprise Department is currently working with the following definitions (The World Bank Group website, SME Department):

- **Microenterprise:** up to 10 employees, total assets of up to \$100,000 and total annual sales of up to \$100,000;
- **Small enterprise:** up to 50 employees, total assets of up to \$3 million and total sales of up to \$3 million;
- **Medium enterprise:** up to 300 employees, total assets of up to \$15 million, and total annual sales of up to \$15 million.

According to the World Bank, the above definitions are broadly consistent with those used by most other international financial institutions.

However, for the purpose of this survey, as the study is in the context of **OCBC Bank** ' s small and medium market business entities, which are belong to Enterprise Banking Department and Emerging Business Department, and defined as industries and entrepreneurs/ enterprises with the **total loans**

amount with the Bank of not exceeding RM50 million and no shareholding relationship with any public listed company.

1.2 SIGNIFICANCE OF THE STUDY

In Malaysia, the government did not pay much attention to the SMEs in the 60s and 70s, there were no special incentives granted to improve productivity for the SMEs. During the 70s, when Malaysia received many foreign direct investments; the SMEs became the supporting industry of the large MNCs. In the 80s, the government began to pay more attention to the SMEs and recognised the importance of SMEs in the development of economic and earning the foreign currency through export.

However, there are still many SMEs are operating in New Villages, which are usually lacking of facilities and infrastructure. With limited capital and resources, the SMEs tend to market locally and have little knowledge and experience in the export market due to their smallness in size and inability to satisfy the large amounts of stock needed by importers.

As such, more study is needed to promote the development of the SME sector.

In Malaysia, strong relationship between SMI and economic growth is found (Mohammad Tariq Naz, 1997). In Mohammad's research, "the data show that a

a high degree of correlation exists between industrial sector and other sectors...
As a whole, the growth of SMI is in-consistent with the growth of economy."

In the Second Industrial Master Plan (IMP2), 1996-2005, small and medium industries (SMIs) are defined as the central to the deepening of key industry clusters. The Eighth Malaysia Plan (8MP), 2001-2005 continues showing strong government support in developing resilient small and medium enterprises (SMEs), especially those with high growth and export potential.

According to SMI Development Plan, as at 1996, SMEs accounted for 93.8 per cent (or 19,951 firms) of all establishments in the manufacturing sector and contributed:

- 27.3 per cent to manufacturing output;
- 25.8 per cent to value-added;
- 27.6 per cent of fixed assets; and
- 38.9 per cent of employment

PRINCIPAL STATISTICS OF MANUFACTURING SECTOR, 1996

	Total	% Share by Size of Firm				Total
		Small	Medium	SMEs	Large	
No. of Firms	20,204	76.0	17.8	93.8	6.2	100.0
Output (RM million)	273,439	3.9	23.4	27.3	72.7	100.0
Cost of Input (RM million)	201,901	3.6	24.2	27.8	72.2	100.0
Value-added (RM million)	71,538	4.7	21.1	25.8	74.1	100.0
Workers ('000)	1,449	11.4	27.5	38.9	61.1	100.0
Salaries (RM million)	19,170	8.2	24.8	33.0	67.0	100.0
Fixed Assets (RM million)	112,831	4.0	23.6	27.6	72.4	100.0

Source: SMIDP Study Report, 2000.

Of the total number of SMEs, small enterprises comprised 76.0 % while medium companies accounted for 17.8 per cent of all manufacturing establishments .In terms of manufacturing output and employment, small enterprises accounted for 3.9 per cent and 11.4 per cent, while medium firms contributed 23.4 per cent and 27.5 per cent respectively (SMI Development Plan 2001-2005, 2002).

Although the total output of SMEs is only 27.3 per cent, but it has contributed 38.9 per cent of employment. Again, it can be explained by the study of Chee Peng Lim that "small industry employs more workers per capital because it tends to use relatively labour-intensive techniques of production" (1975).

The above statistics proved that SMEs is the backbone of the Malaysian economy and contributed significantly to economic development.

As such, in Malaysia, it is very important to foster the SME sector for the development of supporting industries and creating employment.

1.3 SME IN AN INCREASINGLY GLOBALISED ECONOMY

In fostering the SME sector, the more liberalised and globalised business environment has brought more challenges to Malaysian SMEs.

Market integration and the effects of internationalisation have increasingly brought impact to Malaysia SMEs and their ability to compete in both foreign and domestic markets.

When the economic structures are going through the process of liberalization and transformation, traditional capability building approaches are unlikely to support the development of globalise and highly competitive knowledge economy, for instance, costs cutting through cheap labour couldn't enable a company to compete in high competitive and innovative emerging sectors. As such, new approaches like continuing learning; information technology (Enterprise Resources Planning, ERP) and new source of fund (venture capital, early-stage equity investment) are needed.

As such, the Malaysia government has encouraged SMEs to foster linkage with large companies and MNCs through the supply of essential parts, components, vendor schemes, franchisers and services, for instance, the Industrial Linkage Programme (ILP). Besides, various financial packages were introduced such as Technical Assistance Fund (ITAF), training programme such as the Skills Upgrading Programme that finance 50% of the training fees and export incentives such as Export Credit Insurance and Double Deduction for Promotion of Export.

On 2nd May 1996, The Malaysia government has established the Small and Medium Industries Development Corporation (SMIDEC) to provide advisory services, fiscal and financial assistance, infrastructure facilities, market access and other support programmes.

Bank Negara Malaysia has in the Financial Sector Masterplan (FSMP), stated that "the availability of financing to SMEs should continue to remain vital to ensure that these sectors grow providing an economic structure that has greater agility and supports the economy" (Financial Sector Masterplan, 2001).

However, the provision of financing alone is not sufficient to ensure the viability of this industry in the long term. As such, greater efforts need to be channelled towards building the capacity and capabilities of the SMEs to compete in a more liberalised and globalised environment.

In the context of a globalising competition, SMEs have to equip themselves, strengthen their managerial competences and redefine the ways their competitive advantages, e.g. flexible, innovative and close relationship with their customers. Drucker (1974) indicated that small and medium size businesses need organised and systematic management even more than the big business.

Any single factor approach to small industry development is unlikely to be effective. Chee (1975) agreed that removing the financial constraint would not be sufficient to solve the problems of small industry, "all these problems are probably interrelated, ... a pure financial solution to small industry will obviously have a very limited efficacy".

Realising that, FSMP has further indicated that the banks should dedicate resources for provision of a more *comprehensive* financial support including advisory services on financial planning and management. This would contribute towards better financial understanding and building the capacity and capabilities of the SMEs.

To be more competitive, a highly skilled workforce to increase competitiveness and sustainable growth is needed. The acquisition of relevant skills can increase the productivity of labour, allows them to produce more output. Skills development is also a crucial element of any strategy, which aims at improving competitiveness within a firm.

However, most of the SME owners/managers are hesitant to engage in regular formal training, developments. Owner/managers themselves often feel that time restrictions prohibit training, both for workers and for themselves. They will be more willing to participate in training on the job or more informal training where the direct link between cost and benefit is visible. Some of them are even worried that if they have provided training to their employees, those skilled employees will be recruited by their competitors.

Following the intensified globalised business environment, we need to also understand the development of SME sector in other countries.

In **Singapore**, the government realises that the large number of low-productivity SMEs co-exists with a small number of more productive large, local enterprises and foreign MNCs. The key economic challenge is to manage this dualistic

structure such that all enterprises can contribute to the growth of the economy. This requires that a concerted effort be taken to assist SMEs to keep pace with the rest of the economy.

On the other hand, to assisting small businesses in developing countries, the **World Bank Group** (WBG) has in July 2000 launched a new programme, SME Capacity Building Facility, to develop more and better ways to support SMEs. This programme will support the WBG's work on innovative, replicable projects addressing the four key needs of SMEs: capacity building, information and technology, access to capital, and improved business environments. As an important component of the WBG's new SME strategy, the SME Capacity Building Facility will provide grant funding for innovative approaches.

In Malaysia, SMEs account for the majority of firms and large share of employment; as such, SME development is one of the pillars of the Eight Malaysia Plan and the third Outline Perspective Plan (2001-2010). The government also emphasize the need for on going re-positioning of the export of value added products to cater for the higher market segment, and as such, to intensify and step up R & D activities.

In view of that, to survive and win in an increasingly globalised economy, SMEs need to understand the emerging new challenges, re-position themselves and continuously adopt the most effective technology and enhance productivity to remain competitive.

1.4 SCOPE OF THE STUDY

This research will study the present infrastructure in Malaysia, the needs and view of SMEs on the various critical problems they are facing, the developmental initiatives taken to assist the SMEs and the new thinking, new paradigm for SME policy and new challenges in a globalised economy. We will discuss the following:

- Existing SME policies and programme by the government and its responses in Malaysia and other countries;
- The new challenges that are changing the business environment, both domestically and globally; and
- The framework to strengthen the SME sector and to address the concerns of the SMEs.

To address the issues of SMEs in a globalising world, the SME policy is not only about providing tax breaks, credit guarantee and subsidies. It should include a broader set of issues, including training, technology, telecommunications and good corporate governance.

The study will also compare the new approaches and schemes of other countries or organisations. For instances, new model that combines early-stage equity investment and performance-enhancing technical assistance.

1.5 OBJECTIVES AND PURPOSE OF THE STUDY

In view of the importance of SMEs for the development of supporting industries and large share of employment, we need to study the needs of SME development and the impact of globalisation, which has fundamentally shaken up our thinking about the future.

The research is to find out the statuses of SMEs in marketing, problems, government assistance, level of computerization and automation, sources of financing, staff development and their views on advisory services; the new challenges in a globalised economy and subsequently to recommend the efforts needed to further strengthen the present framework of SME sector.

The study hopes to raise awareness of SME development measures amongst SME support bodies, including government bodies like Bank Negara Malaysia and non-government bodies like commercial banks and SME associations.