

SMEs: Building Blocks for Economic Growth¹

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Abstract

Small and Medium Enterprises (SMEs) in Malaysia contribute to economic development by virtue of their sheer numbers and increasing share in employment and Gross Domestic Product. Their role in the Malaysian economy will strengthen the resilience of the country to face a competitive and challenging global environment. The National SME Development Council, chaired by the Prime Minister of Malaysia, has drawn out initiatives to chart the direction and accelerated development of SMEs. These include the establishment and maintenance of a comprehensive National SME Database, expansion of facilities to enhance access to financing, marketing and promotion. In line with the aspirations of the Council, a baseline Census of Establishments and Enterprises covering the main economic sectors of manufacturing, services and agriculture was conducted in 2005. Preliminary findings obtained from the Census are presented to highlight the status and development of SMEs in achieving economic growth.

Introduction

Small and medium enterprises (SMEs) have been the backbone of economic growth of an economy in driving industrial development. Due to their sheer numbers, size and nature of operations, the role of SMEs in promoting endogenous sources of growth and strengthening the infrastructure for accelerated economic expansion and development in Malaysia has been recognised. The interdependence of SMEs and large enterprises in collaborating with each other has led to the further expansion of SMEs.

The potential of SMEs to promote domestic-led growth in new and existing industries and to strengthen the resilience of the economy in a competitive and challenging environment is inarguable. Economic growth in developed countries such as Japan, Korea, Taiwan and many others, was significantly generated by SME activities. The percentage contribution of SMEs to Gross Domestic Product (GDP)/total value added ranges from 60.0 percent in China, 57.0 percent in Germany, 55.3 percent in Japan and 50.0 percent in Korea, compared to 47.3 percent attained by Malaysia (Bank Negara Malaysia, 2003). In order to determine the role of SMEs in the economic growth of Malaysia, it will be meaningful to assess their contribution to the three (3) main sectors of the economy; manufacturing, services and agriculture. Collectively, the share contribution of these three sectors to GDP was estimated to be more than three-quarters of total GDP in 2003. Data for this analysis is obtained through a baseline census of Establishments and Enterprises conducted by the Department of Statistics, Malaysia in 2005.

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The need to develop SMEs

Primary industries were the leading sector of the Malaysian economy for a long time before 1990 as agriculture, mining and quarrying represented 36.9 percent of GDP. However, Malaysia has been successful in transforming the commodity-based economy to an industrialised economy, with manufacturing activities gradually becoming the leading growth sector such that the proportion of the manufacturing sector to GDP rose from 22.1 percent in 1978 to 31.6 percent in 2005. The development of the services sector too has not been left out and its contribution to GDP increased from 38.3 percent to 58.2 percent over the same period.

The economic crisis of 1997-1998 has taught us that the country cannot be overly dependent on foreign direct investment (FDI) to stimulate economic development. Many foreign investors withdrew their investments and relocate to new destinations which are more profitable, especially those that offer cheaper labour costs. SMEs have been targeted as the mechanism in generating domestic-led investment, stimulating economic expansion and increasing the job market for the country. While Malaysia has been able to attract FDI, boost domestic production and exports and create employment opportunities, however, its efforts to strengthen the industrial linkages and enhance the institutional framework have been in part, constrained by the lack of a centralised and comprehensive national database on SMEs. The availability of current, coordinated and relevant SME statistics is crucial to facilitate informed decision-making, formulate development policies, evaluate and monitor the contribution of SMEs to the economy.

Realising the role of SMEs, the government's commitment and concern for the development of SMEs were reinforced when the National SME Development Council, chaired by the Prime Minister of Malaysia, was set up in August 2004. This Council represents the highest-level policy making body to chart the direction and strategies for the development of SMEs. Among the initiatives announced include the formulation of targeted strategies for the development of SMEs across all sectors; the adoption of specific and standard definition for SMEs according to economic activity; the establishment and maintenance of a comprehensive National SME database and the expansion of development support programmes and facilities to enhance access to financing and accessibility of markets for export (Bank Negara Malaysia, 2006).

Census of Establishments and Enterprises 2005

In line with the aspirations of the Council, the Department of Statistics, Malaysia (DOSM) as the largest depository of data for the government has been entrusted with the responsibility of creating a comprehensive national SME database. The action plan outlined includes:

- a. conducting a nation-wide Census of Establishments and Enterprises (reference year 2003) covering the main economic sectors of manufacturing, services and agriculture in 2005;

- b. establishing a frame/database which includes data harmonisation and integration among the various providers of SME.

This paper will present the findings from the baseline Census 2005 undertaken by DOSM (Department of Statistics, Malaysia, 2006) as well as the simultaneous efforts undertaken by DOSM and the relevant agencies in the creation of the database.

Frame

One of the first tasks undertaken was the preparation of the Census frame in the selected sectors, which included:

- a. obtaining a list of all companies and businesses registered with the Companies Commission of Malaysia (CCM);
- b. sourcing a list of establishments/enterprises/entrepreneurs from relevant Ministries and agencies (total of 13 agencies) engaged in SME development;
- c. data cleansing and screening.

The construction of the Census frame was in essence the Central Registry System (CRS) of companies and businesses maintained and coordinated by DOSM. Its main source is the companies and businesses registered with the CCM. This registry only contains information with respect to manufacturing and services including distributive trade sectors.

The additional sources for the frame were a list of all establishments and entrepreneurs registered with the Ministries and related agencies such as Ministry of Agriculture and Agro-based Industry, Ministry of Human Resources, Ministry of Entrepreneur and Co-operative Development, Ministry of Plantation Industries and Commodities, Bank Negara Malaysia, Employees Provident Fund, Inland Revenue Board, Small and Medium Industries Development Corporation, Credit Guarantee Corporation, Multimedia Development Corporation, Local Authorities, etc.

The list of establishments and entrepreneurs obtained from the agencies mentioned above totalled 4.6 million. In order to derive a frame for the Census, DOSM had to screen, match, verify and update the names and addresses of these records to eliminate duplication. Questionnaires were mailed to 1,733,550 establishments/entrepreneurs in the manufacturing (5.0 percent), services (87.9 percent) and agriculture (7.1 percent) sectors in March 2005. As responses to the Census reached only 15.0 percent a month after mailing, field follow-up was initiated to obtain quicker response.

Issues and challenges faced in creating the Census frame include:

- a. The gigantic task of frame creation planned to be completed in nine (9) months, from September 2004 to June 2005, had to be shortened and completed in three (3) months, i.e. mid November 2004 to mid February 2005; (data on SME to be made available for the Ninth Malaysia Plan)
- b. Ideally, the registration numbers of establishments should enable checking and matching to remove duplication; however the respective Ministries and agencies assigned own identification numbers for their own purposes;

- c. Frames sourced from the related agencies were stored in different formats, thus making the job of matching extremely difficult and cumbersome; often manual matching had to be done;
- d. The operating status of the establishments (reference year 2003) was not easily determined from the lists provided; names, addresses were incomplete or overlapping, post codes and description of activity (industry) codes were not available;
- e. In the case of entrepreneurs especially borrowers of bank loans, the names of loan applicants are repeated according to the type of loan.

The benefits of this massive exercise, coupled with the results obtained from the Census, enable the updating of the Central Registry System of DOSM. The posting of current information together with selected variables from the profile of establishments canvassed in the Census, as well as the availability of the establishment frame for the agriculture sector, augurs well for the application of sampling methodology in the conduct of future surveys. Besides the three (3) main sectors mentioned above, the updating of information will be extended to the construction, mining and quarrying sectors after the completion of the Economic Census 2006.

The analysis in this paper is based on the preliminary results obtained from 523,132 establishments/entrepreneurs processed as at October 2005. The definitions for SMEs follow those determined by the National SME Development Council:

Table 1: Definition of SMEs

	<u>Manufacturing</u>	<u>Services</u>	<u>Agriculture</u>
Based on full-time employees			
Micro	Less than 5 employees	Less than 5 employees	Less than 5 employees
Small	Between 5 & 50 employees	Between 5 & 19 employees	Between 5 & 19 employees
Medium	Between 51 & 150 employees	Between 20 & 50 employees	Between 20 & 50 employees
Based on annual sales turnover			
Micro	Less than RM250,000	Less than RM200,000	Less than RM200,000
Small	Between RM250,000 & less than RM10 million	Between RM200,000 & less than RM1 million	Between RM200,000 & less than RM1 million
Medium	Between RM10 million & RM25 million	Between RM1 million & RM5 million	Between RM1 million & RM5 million

Note : An establishment will be classified as a SME if it meets either one of the above criteria

Profile of SMEs

a. Highlights

SMEs in Malaysia account for 99.2 percent or 518,996 of total establishments in the three (3) key economic sectors, namely manufacturing, services and agriculture. Large establishments numbering 4,136 accounted for the remaining 0.8 percent. Most of the SMEs predominate in the services sector, accounting for 86.5 percent of the total establishments. Their presence in the manufacturing and agriculture sectors are only 7.3 percent and 6.2 percent respectively.

Employment generated by SMEs was approximately 3.0 million workers (65.1 percent) of the total employment of 4.6 million engaged in the three (3) main sectors. The services sector employed the largest number, 2.2 million, followed by the manufacturing sector, 740,438 and agriculture sector, 131,130. Full-time employees totalled 2.3 million workers (76.5 percent) while self-employed workers made up 16.7 percent and part-time workers, the remainder (6.8 percent).

The role of SMEs in the Malaysian economy is demonstrated by their contribution to output and value added, RM405 million and RM154 million respectively in 2003 (see Table 2). In terms of share contribution, SMEs accounted for 43.5 percent of total output and 47.3 percent of value added. It is noted that SMEs in the services sector contributed the largest share, 56.7 percent and 54.7 percent respectively. SMEs in the manufacturing sector saw a 34.9 percent contribution in output and 37.1 percent in value added.

Table 2: Output and value added by sector, 2003

Sector	Output (RM billion)			Value added (RM billion)		
	Total	SMEs	%	Total	SMEs	%
Manufacturing	549.1	191.6	34.9	128.1	47.5	37.1
Services	361.7	204.9	56.7	187.6	102.7	54.7
Agriculture	20.6	8.7	42.1	9.1	3.6	39.7
Total	931.4	405.2	43.5	324.7	153.7	47.3

More than three quarters of SMEs (411,849) are micro establishments and they are predominantly present in the services and agriculture sectors, accounting for 80.4 percent and 93.3 percent respectively. Small establishments constitute 18.4 percent and medium establishments, 2.2 percent. This pattern was also prevalent in the manufacturing sector. However, the proportion of micro establishments was lower, 55.3 percent, while small establishments accounted 39.5 percent.

SMEs were mainly concentrated in the Central Region (Federal Territory Kuala Lumpur and Selangor), accounting for 37.1 percent. Johor was next with 10.4 percent,

followed by Perak with 7.3 percent while Perlis registered only 1.1 percent of the total establishments. The rest of the states accounted for less than 44.1 percent.

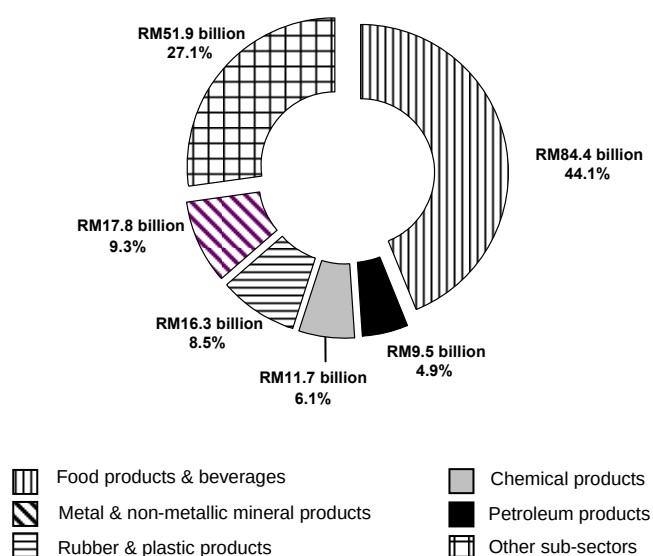
b. SMEs in manufacturing

SMEs accounted for 96.6 percent (37,866) of total establishments in the manufacturing sector. Micro establishments numbered 20,952 or 55.3 percent while medium-sized establishments numbered 1,969 (5.2 percent).

Approximately 34.9 percent of total output of this sector or RM191.6 billion was contributed by SMEs. It is interesting to note that medium-sized establishments contributed 62.1 percent of output and small establishments, 35.6 percent. The share of output by micro establishments was negligible, 2.3 percent. The largest number of SMEs was found in the traditional sectors of textiles and apparels (23.2 percent), metal and non-metallic mineral products (16.7 percent) and food and beverages (15.0 percent), whereby collectively they accounted for more than half (54.9 percent) of the total number of establishments in this sector.

By industry sub-sectors, food products and beverages topped the list with 44.1 percent of output generation (see Chart 1). Metal and non-metallic mineral products together with rubber and plastic products contributed 17.8 percent of output. SMEs in the electronics sub-group contributed only 1.1 percent of SME's output, as compared to 18.9 percent in terms of total output. In contrast, the contribution of output of SMEs in food products and beverages to the sub-sector's output was 70.3 percent, which was the highest among all the sub-sectors.

Chart 1: Output of SMEs in manufacturing sub-sectors, 2003



In terms of employment, the four sub-sectors of food and beverages; wood products and furniture; metal and non-metallic mineral products; and rubber and plastic products engaged more than half of the work force of SMEs.

c. SMEs in services

SMEs accounted for 99.4 percent (449,004) of total establishments in the services sector. The profile in this sector indicates that 80.4 percent of SMEs are characterised as micro, 17.6 percent as small and 2.0 percent as medium establishments.

More than half of SMEs (55.3 percent) were concentrated in the wholesale and retail sub-sector, 14.5 percent in restaurants and hotels and 6.2 percent in transport and communications. The other sub-sectors of professionals, health, education, real estate activities, business/management consultancy made up the remaining 24.0 percent.

Output generated by SMEs was 56.7 percent of total output (RM361.7 billion) in the services sector. SMEs in the restaurant sub-sector (including cafes, coffee shops, hawkers and stalls) accounted for 85.1 percent of output of the restaurant services; followed by real estate activities (79.3 percent); retail (79.1 percent); business/management consultancy (74.2 percent) and professionals (71.7 percent). In contrast, SMEs in the telecommunication sub-sector contributed 1.9 percent of output, indicating the dominance of large establishments in this sub-sector.

d. SMEs in agriculture

SMEs in the agriculture sector accounted for 99.2 percent of the 32,397 establishments enumerated. About 93.3 percent (29,985) of SMEs are categorised in the micro category.

The contribution of SMEs to the output of the agriculture sector was 42.1 percent (RM8.7 billion). Small establishments accounted for 41.4 percent of output and 41.7 percent of value added. The largest share of output was contributed by the sub-sectors, growing of crops, market gardening, horticulture and livestock farming, collectively accounting for 72.2 percent.

Workers employed by SMEs numbered 131,130 or 57.5 percent of total workers in the agriculture sector. Micro establishments were characterised by a high percentage of working proprietors and active business partners, 97.5 percent.

The concentration of SMEs in the states has a close relationship with the dominant economic activity. In Kedah where agriculture is the main stay of the economy, the number of SMEs was the largest, 8,803 (27.4 percent) followed by the east coast states with 26.6 percent.

e. Employment by educational qualification - SMEs

The percentage of persons engaged by qualification in SMEs was similar to that of large establishments as illustrated in Table 3. In the manufacturing and agriculture sectors, the percentage of degree holders employed by SMEs and large establishments were close, while in the services sector, the proportion engaged by large establishments was 12.8 percent compared to 7.6 percent by SMEs. SMEs in the services sector employ 27.9 percent of degree and diploma/*Sijil Tinggi Pelajaran Malaysia* (STPM) holders, compared to 14.3 percent and 5.2 percent for manufacturing and agriculture respectively. Generally, it can be said that Malaysian companies and businesses employ a high proportion of *Sijil Pelajaran Malaysia* (SPM) holders and below in their work force.

Table 3: Persons engaged by educational qualification - SMEs 2003

		Category			Total
		Degree	Diploma/ STPM	SPM and below	
Manufacturing	SMEs	4.1	10.2	85.7	100.0
	Large	5.9	11.5	82.6	100.0
Services	SMEs	7.6	20.3	72.1	100.0
	Large	12.8	19.5	67.7	100.0
Agriculture	SMEs	1.1	4.1	94.7	100.0
	Large	1.3	2.6	96.1	100.0

f. Women in SMEs

Women participation in the work force of SMEs in 2003 was 1,121,687 or 36.8 percent of total employment. Specifically, the involvement of women entrepreneurs in SMEs, by using working proprietors and active business partners as a proxy, indicated 30.3 percent participation.

The percentage of female employees in the managerial and professional category was the highest, 48.5 percent compared to 40.8 percent in the clerical, production and operative workers category and 21.1 percent in the technical and supervisory category.

A comparison of the trends of women participation in SMEs in the manufacturing sector obtained from Census 2000 (Department of Statistics, Malaysia, 2001) and Census 2003 indicated that women employed in the managerial and professional category in Census 2003 was 26.8 percent compared with 21.2 percent attained in Census 2000. The corresponding percentages in the technical and supervisory category were 17.0 percent and 15.3 percent. Women entrepreneur participation in SMEs increased from 18.0 percent in Census 2000 to 27.8 percent in Census 2003.

g. SMEs sources of financing

SMEs generally use their own funds or internally generated funds (including borrowings from friends or family) as the prime source of financing for their business operations. This represented 57.6 percent of financing accessed by Malaysian SMEs. The Census results indicated that SMEs rely to a lesser extent on financial institutions and government loans, 13.7 percent.

Analysing further, 43.9 percent of medium-size SMEs made use of financial institutions as their prime source of financing. Micro establishments, on the other hand, accounted for only 13.4 percent while preferring to rely on own contribution/internally generated funds (31.4 percent). As SMEs grow in size, they tend to rely more on financial and commercial institutions as sources of financing.

SMEs generally face difficulties in obtaining financing. The most significant problem faced by SMEs in the three sectors was the lack of collateral. The other difficulties included insufficient documents to support loan application, lack of financial track record and viability of businesses (see Table 4). These accounted for more than 80.0 percent of listed difficulties in all sectors. At the same time, 9.8 percent of SMEs also reported that processing time for loan applications was an added constraint.

Table 4: Constraints in accessing financing - SMEs 2003

List of Difficulties	Total %	Manufacturing %	Services %	Agriculture %
Lack of collateral	55.2	56.6	55.1	54.7
Insufficient documents to support loan application	13.1	11.7	12.9	17.0
No financial track record	10.7	9.8	10.7	11.0
Long loan processing time	9.8	8.4	10.2	7.0
Business plan deemed not viable by financial institutions	5.3	6.0	5.4	4.1
Others*	6.0	7.6	5.8	6.2

Note: *including existing non-performing loans with another financial institutions and lack of technical expertise of financial institutions to assess loan applications

h. SMEs marketing and promotion activities

From the responses obtained in the Census, only 12.9 percent of SMEs undertake promotion for their products and services. The medium of marketing commonly used was the media, followed by participation in local trade expos and efforts in promoting and developing brand names, each accounting for 4.9 percent, 2.8 percent and 2.5 percent respectively (see Table 5).

Table 5: Marketing and promotion activities - SMEs 2003

Marketing activities	Total %	Manufacturing %	Services %	Agriculture %
Media promotion	4.9	10.9	4.7	0.7
Local trade expo	2.8	7.8	2.5	1.0
Overseas trade expo	0.6	3.1	0.4	0.1
Linkages with foreign companies	1.1	4.0	0.9	0.1
Brand name	2.5	9.9	2.0	0.2
Others*	1.0	1.1	1.1	0.5
Total	12.9	36.8	11.6	2.6

Note: * including franchise operations and owned or managed by franchisor

i. Export-oriented enterprises²

The action plan promulgated for SMEs is to look towards non-traditional markets for export opportunities. In 2003, SMEs which qualified as an export-oriented industry constituted only 0.4 percent while generating an output of 8.5 percent, value-added of 6.4 percent and engaging 2.7 percent of employees. The manufacturing sector contributed 18.5 percent of output, 1.5 percent value-added and generated 11.1 percent employment, although the number of SMEs involved was only 3.0 percent.

The potential for agriculture and services sectors to be an export-oriented industry was 0.2 percent of total SMEs (see Table 6).

² The establishment is assumed as an export-oriented industry if its export-product is 50 percent and more.

Table 6: Contribution by export oriented SMEs, 2003

Sector	No. of establishments %	Output %	Value Added %	Employment %
Manufacturing	3.0	18.5	21.5	11.1
Services	0.2	0.7	0.7	0.3
Agriculture	0.2	0.2	1.3	1.7
Total	0.4	8.5	6.4	2.7

j. The future

◆ National SME Database

The ensuing task of DOSM after the undertaking and completion of the Census is the establishment and maintenance of the National SME Database. Data from the Census will serve as baseline information for the database which will, among others, focus on:

- i. harmonising of information across identified sources and providers of SME information, including common classifications;
- ii. system of integrating data from various agencies; and
- iii. maintenance and updating of data on a regular basis.

The development of the system is planned from the middle of 2006 and is targeted to be operational by 2007. Items of information in the database should conform to key areas such as:

- i. Overview/Status of SME development
- ii. Contribution of SME to the economy
- iii. Financial management
- iv. Access to financing
- v. Production and operational management
- vi. Access to technology and technological advancement
- vii. Human resource
- viii. Marketing and promotion
- ix. Access to government assisted programmes

The success of the database will very much be dependent on the Ministries and agencies that must be committed and provide full cooperation in the development and implementation of the database. The regularity of data needed, the frequency of updating, the standardisation of information and the production of regular reports are issues that are currently addressed.

◆ **Economic Census, 2006**

The Economic Census 2006 (reference year 2005) which is currently conducted by DOSM, provides continuing work on updating of SME indicators in monitoring economic growth. Through this Census, data on the construction and mining/stone quarrying sectors in respect of SMEs will also be collected to complement the database of the three sectors. This coverage is also extended to the services sub-sectors such as content writing, home stay, chalets, dialysis centres, dietetics and nutrition services.

k. Conclusion

The potential of Malaysian SMEs to contribute significantly to economic growth is demonstrated by their contribution to output, their numbers (half a million) and substantial employment generation (labour-intensive). Our large SME base is capable of providing immense opportunities for SMEs to become catalyst in the economy. With the adoption by the Government of a more comprehensive approach towards SME development such as increasing their access to financing, providing greater access to business facilities locally and abroad, enabling business infrastructure, the way forward for SMEs then is for them to enhance human capital development, be adaptive in the use of information technology and improve their operations and productive capabilities to move up the value chain in order to remain competitive. SMEs must be strengthened to be the next engine of growth. To summarise, the Ninth Malaysia Plan envisages **“to develop competitive and resilient SMEs that are equipped with strong technical and innovation capacity as well as managerial and business skills”** to innovate the country to higher economic growth (Government of Malaysia, 2006).

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