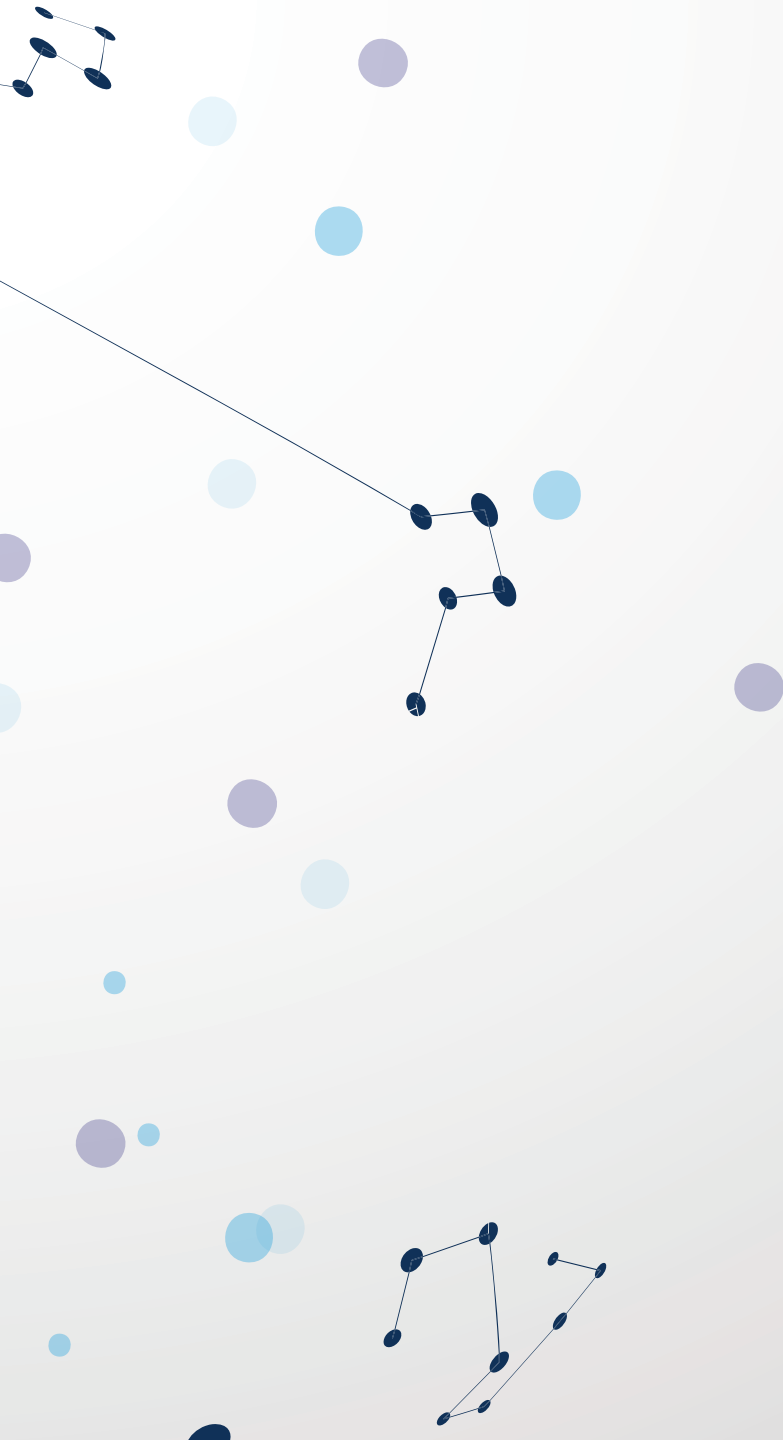


Section I : Economic Assessment

Chapter 2

SME

Developments and Outlook



Chapter 2

SME Developments and Outlook

In line with the performance of Malaysian economy in 2017, SMEs in Malaysia recorded a higher economic growth of 7.2% in 2017 (2016: 5.2%), driven by strong domestic demand, led by both consumption and investment activities, higher SME exports as well as continued growth in employment and income. The higher SME growth was also reflected across all major economic sectors. Nevertheless, going forward in 2018, SME Gross Domestic Product (GDP) growth is expected to expand at the lower-end of the projection range of 7.0 - 8.0%, given that Bank Negara Malaysia (BNM) has revised the overall GDP growth projection to 5.0%, below the official overall GDP growth projection of 5.5 - 6.0% in 2018. The growth will be supported by higher private consumption, improved business sentiment and consumer confidence as well as favourable global economic outlook. In addition, greater certainty in domestic policies and initiatives by the new Government is expected to provide support to growth prospects.

DEVELOPMENTS OF SMEs IN ADVANCED AND EMERGING ECONOMIES

Being the Central Coordinating Agency for SME development in Malaysia, SME Corp. Malaysia represents the voice of SMEs and the proponents of their growth in international platforms, such as the Association of Southeast Asian Nations (ASEAN), Asia Pacific Economic Cooperation (APEC) and Organisation for Economic Cooperation and Development (OECD). Over the years, the contribution of SMEs to economic growth, employment and development in the region plays a crucial part in achieving sustainable economic development and regional economic integration.

In ASEAN, SMEs constitute a large number of establishments in all ASEAN member states, ranging between 88.8 - 99.9% and contribute significantly in creating employment opportunities, ranging between 51.7 - 97.2%. Focusing on the ASEAN Economic Community, at the regional level,

programmes and initiatives on SME development will be guided by the ASEAN Strategic Action Plan for SME Development 2016 - 2025 (SAPSMED 2016 - 2025), which gives strong emphasis on innovation, technology and productivity. In this Plan, Malaysia and Lao PDR are the country champions for Strategic Goal B (SGB): Increase Access to Finance which are responsible to lead, coordinate, implement and monitor SGB initiatives at the regional level.

Under the SGB, various initiatives have been implemented at ASEAN level such as Basic Research on SMEs Access to Finance Environment, Credit Guarantee System (including credit insurance) and Credit Information; SME Finance Roadshow; ASEAN Institutional Framework on Access to Finance for MSME and Facilitating Equity Crowdfunding (ECF) in the ASEAN Region. On top of that, Malaysia being the champion of this initiative strategic goal, has undertaken a project in the country on the establishment of an online SME financing platform to overcome information asymmetry between financial institutions (FIs) and SMEs which then enable SMEs to source financing solution needs efficiently and seamlessly. The Train-the-Trainers Programme on SME Financing was also conducted nationwide to build the capacity and capability of FIs in order to provide quality advisory services to SMEs.

In 2018, Singapore resumes the chairmanship of ASEAN under the theme 'Resilient and Innovative'. The occasion will encapsulate the key vision for ASEAN to be united in the face of growing uncertainties in the global economic landscape. Recognising the emerging of ground-breaking technologies and future trends, these disruptive digital technologies bring about vast opportunities as well as challenges. Thus, SMEs must be adaptable and forward looking in equipping themselves with necessary skills to boost their capabilities and build a future-ready ASEAN.

In accordance to the vision to develop progressive SMEs, the rich platform of APEC provides great opportunities for SMEs to learn about good policies and best practices as well as create synergy among the SMEs in other member economies. Echoing the rising of digital economy as the enabler in today's businesses, APEC 2018 which was hosted by Papua New Guinea came up with the theme 'Harnessing Inclusive Opportunities, Embracing the Digital Future'. The three key priorities being highlighted relates to improving connectivity and deepening regional economic integration; promoting sustainable and inclusive growth as well as strengthening inclusive growth through structural reform. Through this theme, 21 member states will strategically work on growth, inclusivity and sustainability, while at the same time, embrace critical opportunities in the digital economy for the benefit of SMEs.

Meanwhile, the advance of Internet economy and digital transition have the potential to unlock finance for SME, such as financial technology (Fintech) and alternative financing

Meanwhile, the advance of Internet economy and digital transition have the potential to unlock finance for SME, such as financial technology (Fintech) and alternative financing. Looking at the financing side, the OECD 2018 Scoreboard on 'Financing SMEs and Entrepreneurs' provides information on the SME finance conditions and trends. The Scoreboard indicated that finance environment for SMEs has improved, with bankruptcies in 2016 fell in majority of OECD countries and non-performing loans were lower than the post financial crisis period. Survey data also signalled favourable credit conditions, with lower SME interest rates and a decline in loan rejection rates in many countries. Nevertheless, challenges still persist. Findings highlighted that new bank lending to SMEs decreased in many countries in 2016. Some countries pointed the low bank lending was mainly due to weak demand for credit, weak macroeconomic performance, slow economic recovery and risk aversion in the financial sector.



In the face of these challenges, SMEs are increasingly turning to alternative financing instruments. This diversification of financing avenues is crucial as many SMEs still over-reliant on bank credit and some continue to face financing constraints which becomes a barrier towards growth. The evolving landscape in SME financing depicts the pervasiveness of technology platforms and redefine a new way of doing business for SMEs.

Honouring the significant contribution and importance of SMEs as the growth engine of a country's economy, the General Assembly of the United Nations in April 2017 has declared 27 June as the World Micro, Small and Medium-sized Enterprises (MSME) Day. With the main goal to increase public awareness in supporting small business towards greater achievement, the special dedicated day for SMEs also acts as a platform in fostering research presentations, policy discussions, practitioner workshops and at the same time commemorates the spirit of entrepreneurship across the globe.

PERFORMANCE OF SMEs IN MALAYSIA

Overview: Growth Trends of SMEs during 2011 - 2017

Based on the statistics on SMEs by the Department of Statistics, Malaysia, real GDP growth of SMEs has consistently outperformed the overall economy with the **average annual growth rate** of SMEs at **6.6%** compared to 5.2% for the overall GDP in the growth period of 2011 - 2017. This has resulted in the contribution of SMEs to overall GDP increased from 32.2% in 2010 to **37.1%** in **2017**.

In terms of performance by economic sectors, the increase in share of SMEs to GDP in the growth period of 2011 - 2017 was largely contributed by the services sector and further supported by the construction sector. This is reflected by the higher average annual growth rates for SME construction sector at 9.7% and SME services sector at 7.0%, compared to the overall SME GDP average growth rate of 6.6% (refer to Table 2.1).

Table 2.1: SME GDP by Economic Sector (constant 2010 prices)

SME GDP by Economic Sector	SME Contribution to GDP			SME GDP Growth
	2010	2017	Increase / decrease in share	CAGR ¹ 2011-2017 (%)
	Share (%)			
Overall²	32.2	37.1	+4.9	6.6
Agriculture	4.3	4.1	-0.2	2.9
Mining & Quarrying	0.05	0.2	+0.15	9.1
Manufacturing	7.2	8.0	+0.8	6.4
Construction	0.9	2.2	+1.3	9.7
Services	19.6	22.1	+2.5	7.0

¹ CAGR refers to compounded annual growth rate (underlying growth of 7.9% for 2014)

² Total value-added after taking into account import duties

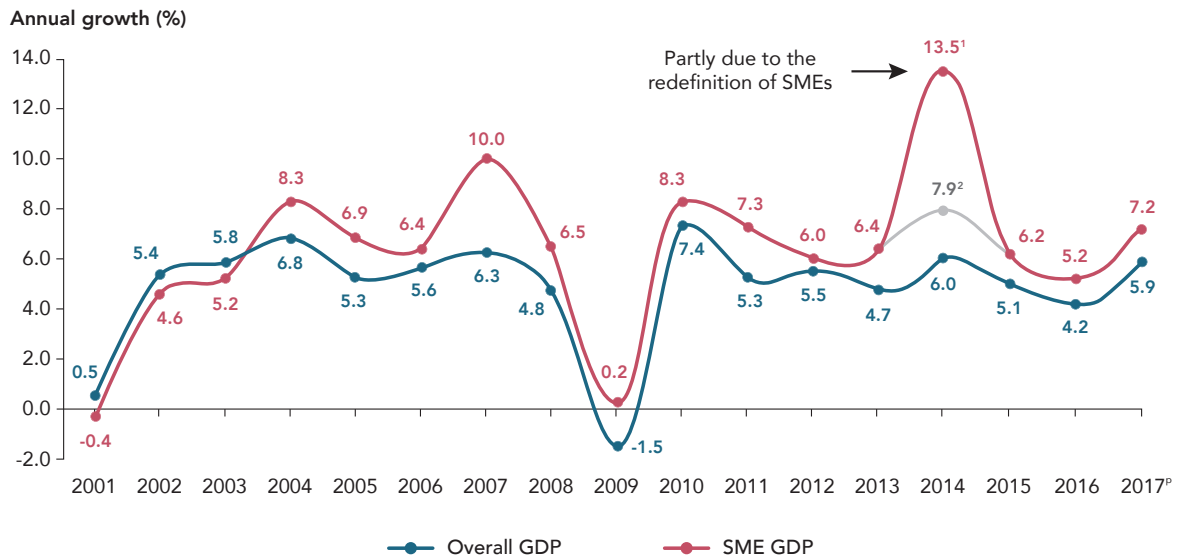
Source: Department of Statistics, Malaysia

PERFORMANCE IN 2017

In 2017, SMEs recorded a higher GDP growth of 7.2% compared to 5.2% in the previous year and continued to surpass the overall GDP growth of 5.9%. The higher SME GDP growth was supported by strong domestic demand, led by both private consumption and investment activities, sustained domestic and foreign tourist spending, partly from hosting the 2017 Southeast Asian (SEA) Games as well as higher exports demand for products and services of SMEs from ASEAN and other trading partners.



Chart 2.1: SME GDP and Overall GDP Growth (%)



¹ Growth based on 2014 New SME Definition versus 2013 Old SME Definition

² Growth based on 2014 New SME Definition versus 2013 New SME Definition

p: preliminary

Source: Department of Statistics, Malaysia and SME Corp. Malaysia

On the **supply side**, most economic sectors of SMEs registered higher growth in 2017 compared to the previous year. The performance of the two main sectors, services and manufacturing, benefited from improvements in domestic and external conditions. Meanwhile, growth of SMEs in agriculture sector rebounded to 7.3% (2016: -1.9%) due to the turnaround of palm oil production and other agricultural crops. When compared between the overall economy and SMEs, the SME GDP growth was higher across all economic sectors except construction sector (refer to Table 2.2).

Table 2.2: SME GDP and Overall GDP Growth by Economic Sector (constant 2010 prices)

	2016 SME GDP	2017 SME GDP	2017 Overall GDP
	Annual growth (%)		
Agriculture	-1.9	7.3	7.2
Mining & Quarrying	8.2	8.9	1.0
Manufacturing	4.8	6.8	6.0
Construction	6.8	6.6	6.7
Services	6.5	7.3	6.2
Total	5.2	7.2	5.9

Source: Department of Statistics, Malaysia

Table 2.3: SME GDP and Overall GDP Share by Economic Sector (constant 2010 prices)

	2017	
	SME GDP	Overall GDP
	Percentage share to total (%)	
Services	59.7	54.5
Manufacturing	21.5	23.0
Agriculture	11.2	8.2
Construction	5.8	4.6
Mining & Quarrying	0.4	8.4
Plus: import duties	1.4	1.4
Total	100.0	100.0

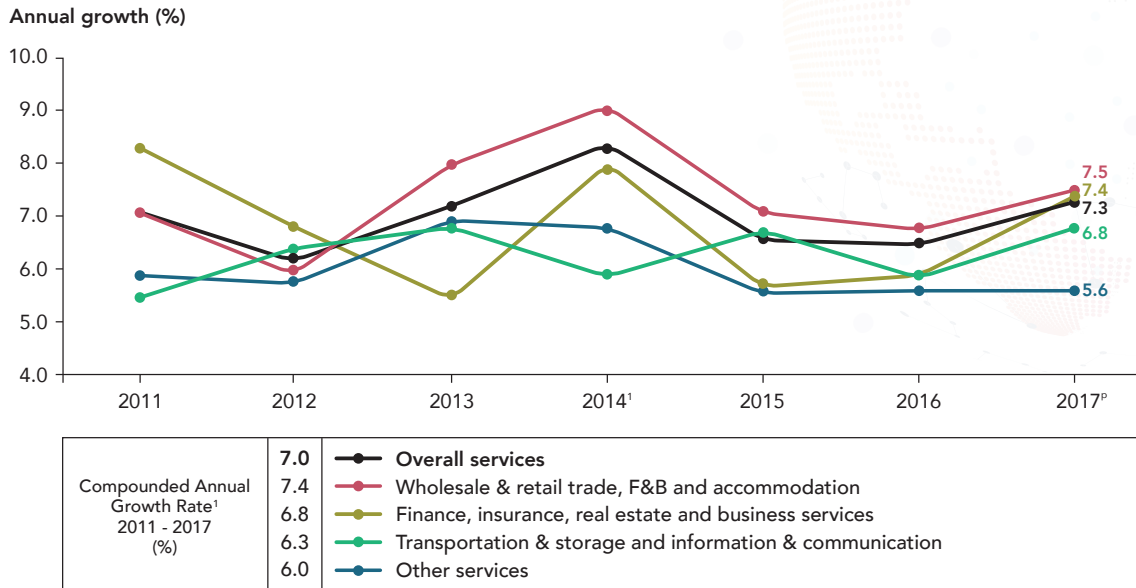
In terms of **sectoral contribution** to SME GDP in 2017, the services sector was the largest contributor (59.7%) to total SME GDP, followed by manufacturing (21.5%), agriculture (11.2%), construction (5.8%) and mining & quarrying (0.4%). The SME GDP structure is somewhat similar to the overall GDP structure with the exception that contribution of SME GDP in mining & quarrying is small given the fact that SMEs in this sector accounted for only a small share of total establishments of SMEs and mainly from the quarrying segment (refer to Table 2.3).

Note: Figures may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia

SME Value-added in the Services Sector

Chart 2.2: SME Value-added Growth of Sub-sectors in the Services Sector (%)



¹ Growth based on 2014 New SME Definition versus 2013 New SME Definition (redefinition effect has been eliminated)

p: preliminary

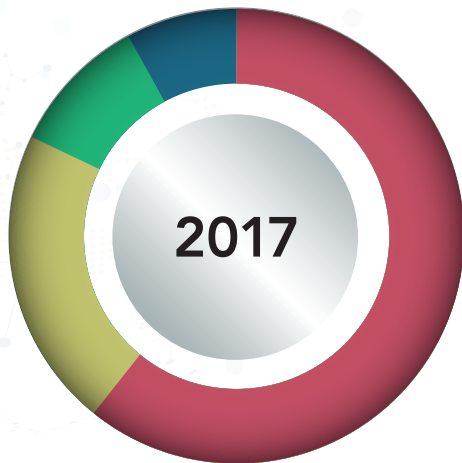
Source: Department of Statistics, Malaysia

Value-added of SMEs in the **services sector** recorded a growth of 7.3% in 2017 (2016: 6.5%), supported by expansion across all sub-sectors. The wholesale & retail trade, F&B and accommodation sub-sector which accounted for 62.3% of SME value-added in the services sector grew at the fastest pace of 7.5%. Growth was underpinned by retail trade and motor vehicle segments.

The wholesale & retail trade, F&B and accommodation sub-sector which accounted for 62.3% of SME value-added in the services sector grew at the fastest pace of 7.5%



Chart 2.3: Components of Value-added of SMEs in the Services Sector (%)



- 62.3% Wholesale & retail trade, F&B and accommodation
- 20.3% Finance, insurance, real estate and business services
- 10.3% Transportation & storage and information & communication
- 7.2% Other services

Note: Figures may not necessarily add up due to rounding

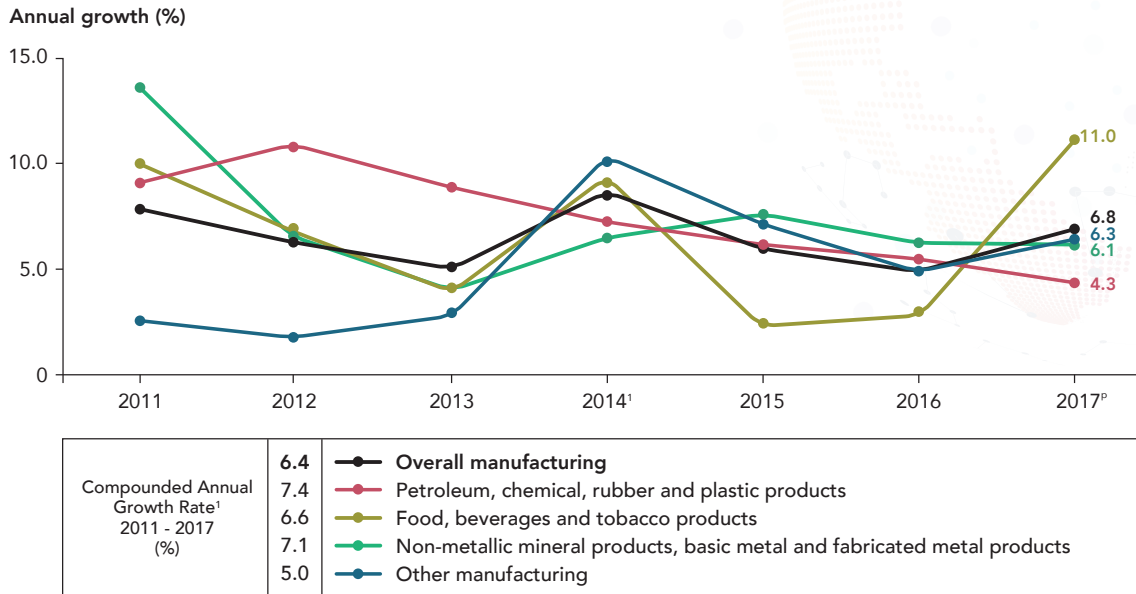
Source: Department of Statistics, Malaysia

Growth in the finance, insurance, real estate and business services sub-sector as well as transportation & storage and information & communication sub-sector were further supported by higher consumer and business spending in line with improving consumer sentiments and business conditions.



SME Value-added in the Manufacturing Sector

Chart 2.4: SME Value-added Growth of Sub-sectors in the Manufacturing Sector (%)



¹ Growth based on 2014 New SME Definition versus 2013 New SME Definition (redefinition effect has been eliminated)

p: preliminary

Source: Department of Statistics, Malaysia

In 2017, the SME value-added in the **manufacturing sector** increased by 6.8% (2016: 4.8%), led by food, beverages and tobacco products sub-sector which registered a double-digit growth of 11.0% benefiting from the higher demand for food-related products. In non-metallic mineral products, basic metal and fabricated metal products sub-sector, growth was sustained at 6.1% in 2017 (2016: 6.2%), supported by basic metal. Meanwhile, petroleum, chemical, rubber and plastic products sub-sector expanded at a slower pace at 4.3% (2016: 5.4%).



Chart 2.5: Components of Value-added of SMEs in the Manufacturing Sector (%)

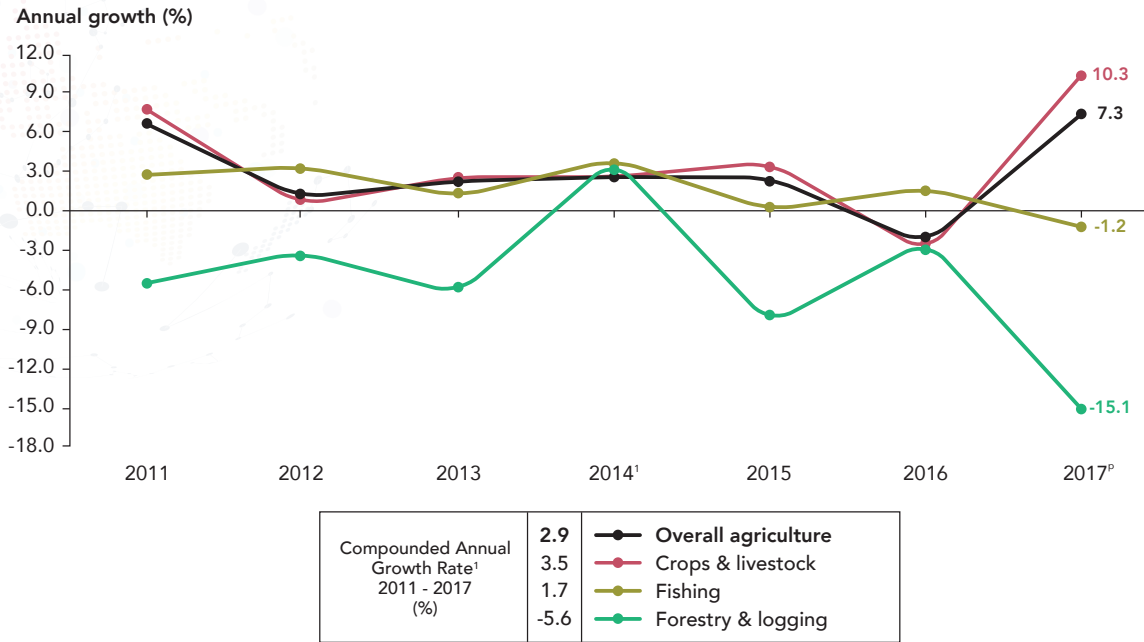
- 23.9% ■ Petroleum, chemical, rubber and plastic products
- 21.8% ■ Food, beverages and tobacco products
- 18.6% ■ Non-metallic mineral products, basic metal and fabricated metal products
- 35.7% ■ Other manufacturing

Note: Figures may not necessarily add up due to rounding

Source: Department of Statistics, Malaysia

SME Value-added in the Agriculture Sector

Chart 2.6: SME Value-added Growth of Sub-sectors in the Agriculture Sector (%)



¹ Growth based on 2014 New SME Definition versus 2013 New SME Definition (redefinition effect has been eliminated)

p: preliminary

Source: Department of Statistics, Malaysia

In the **agriculture sector**, SME value-added growth rebounded to 7.3% (2016: -1.9%), driven mainly by double-digit growth in agricultural crops & livestock sub-sector, including rubber and palm oil. The production of rubber and oil palm increased as yields recovered from the negative impact of El Niño in 2016. This sub-sector continued to remain the largest contributor (80.6%) to SME value-added in the agriculture sector.

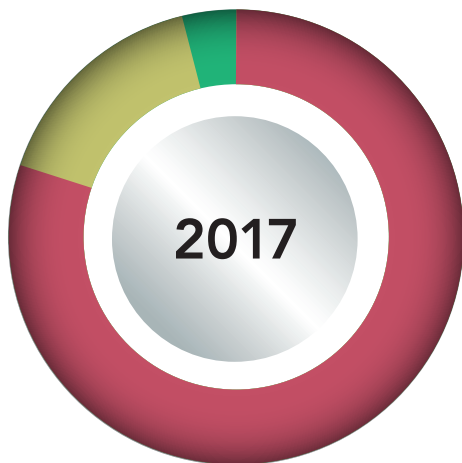


Chart 2.7: Components of Value-added of SMEs in the Agriculture Sector (%)

80.6% ■ Crops & livestock

16.1% ■ Fishing

3.3% ■ Forestry & logging

Note: Figures may not necessarily add up due to rounding

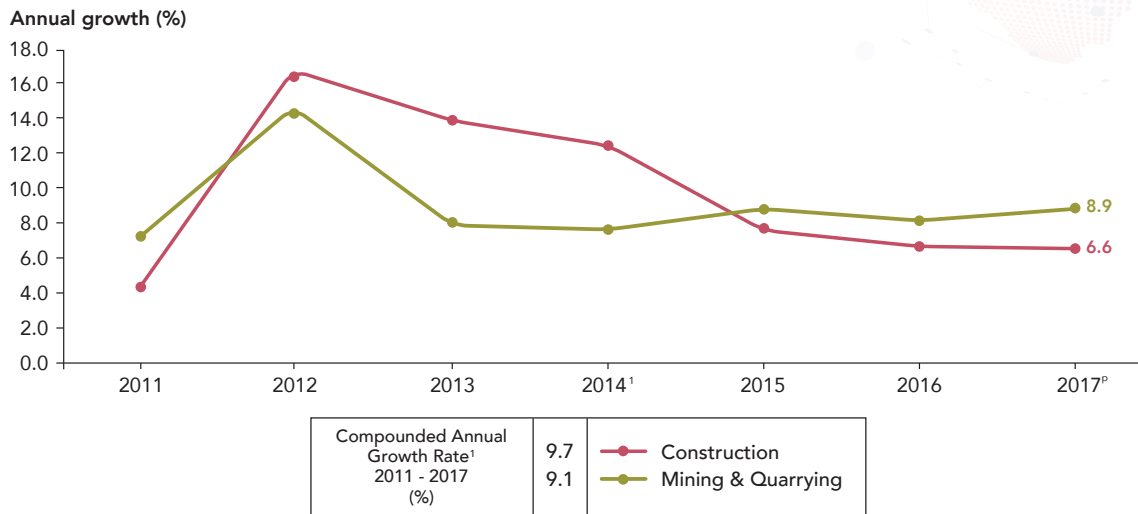
Source: Department of Statistics, Malaysia

SME Value-added in the Construction and Mining & Quarrying Sectors

The value-added growth of SMEs in the **construction sector** was sustained at 6.6% in 2017 (2016: 6.8%), following slower activities in special trades and civil engineering. The overall performance of the sector was also affected due to slower construction growth in residential buildings.

Meanwhile, value-added of SMEs in the **mining & quarrying sector** recorded a higher growth of 8.9% in 2017 compared to 8.2% in the previous year, underpinned by strong stones, rocks & granite quarrying activities which account for 38.5% of the total SME value-added in the mining & quarrying sector.

Chart 2.8: SME Value-added Growth in the Construction and Mining & Quarrying Sectors (%)

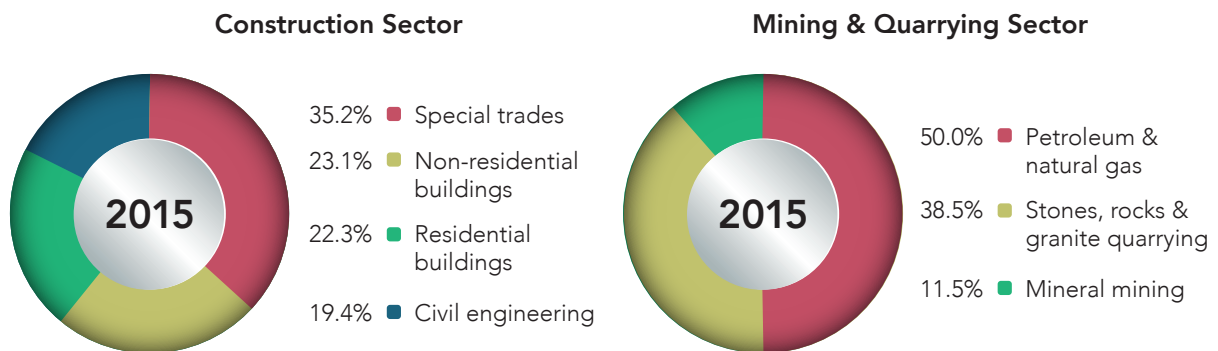


¹ Growth based on 2014 New SME Definition versus 2013 New SME Definition (redefinition effect has been eliminated)

p: preliminary

Source: Department of Statistics, Malaysia

Chart 2.9: Components of Value-added of SMEs in the Construction and Mining & Quarrying Sectors (%)

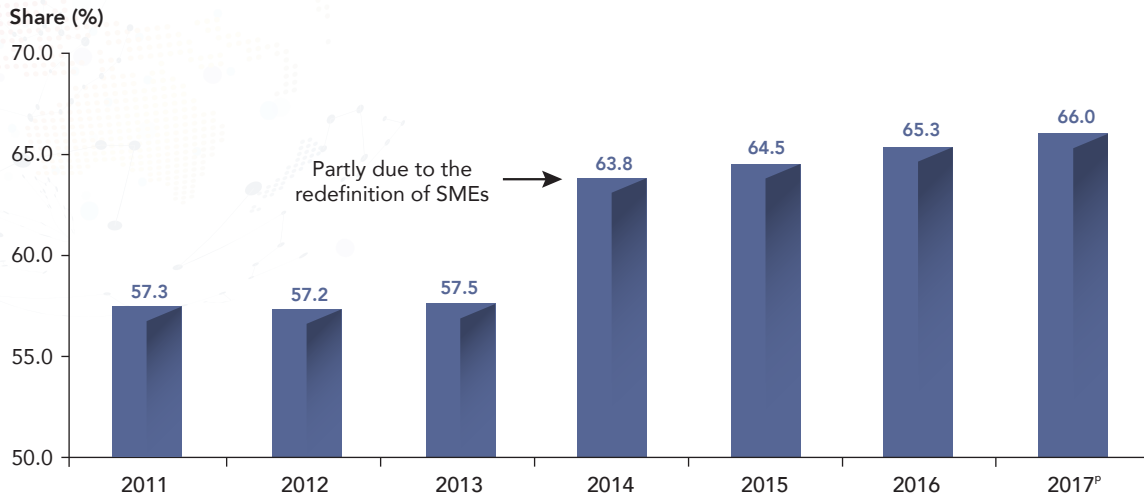


Note: Figures may not necessarily add up due to rounding

Source: Economic Census 2016: Profile of Small and Medium Enterprises (reference year 2015), Department of Statistics, Malaysia

Employment of SMEs

Chart 2.10: Percentage Share of SME Employment to Total Employment (%)



Note: Calculation of employment estimated from various establishment surveys

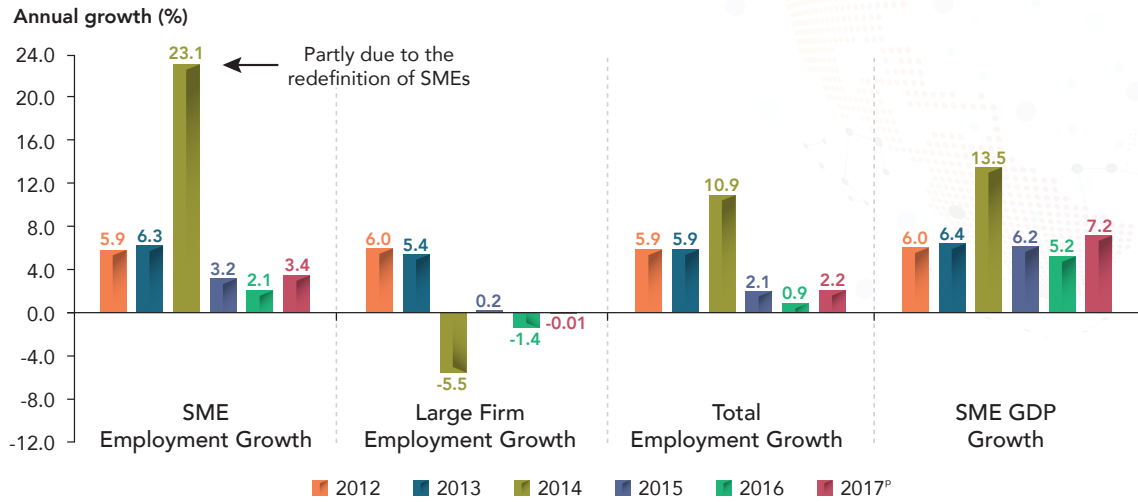
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Source: Department of Statistics, Malaysia



In **2017**, SMEs accounted for **66.0%** of total employment in Malaysia (2016: 65.3%) as employment of SMEs continued to increase with a growth of **3.4%** (2016: 2.1%) (refer to Chart 2.10 and 2.11), in line with the trend in GDP growth of SMEs. The growth for SME employment was higher while large firms remained flat at -0.01% in 2017, partly due to a shift of employment from large firms to SMEs. In terms of SME employment by economic sector, about 62.0% of SME employment were generated by the services sector, particularly in the distributive trade, food & beverages and professional, scientific & technical sub-sectors. Meanwhile, manufacturing sector was the second largest contributor (16.5%) followed by agriculture (11.0%), construction (10.5%) and mining & quarrying (0.3%).

Chart 2.11: Employment Growth Performance by Firm Size (%)

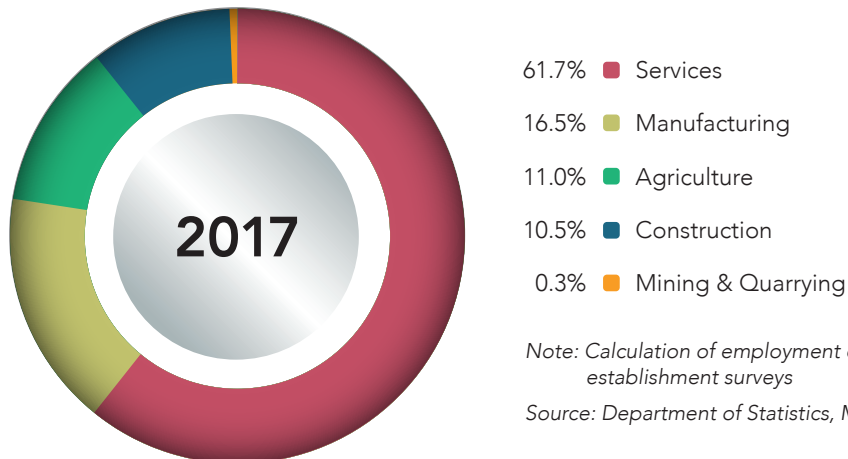


Note: Calculation of employment estimated from various establishment surveys

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Source: Department of Statistics, Malaysia

Chart 2.12: Components of SME Employment by Economic Sector (%)

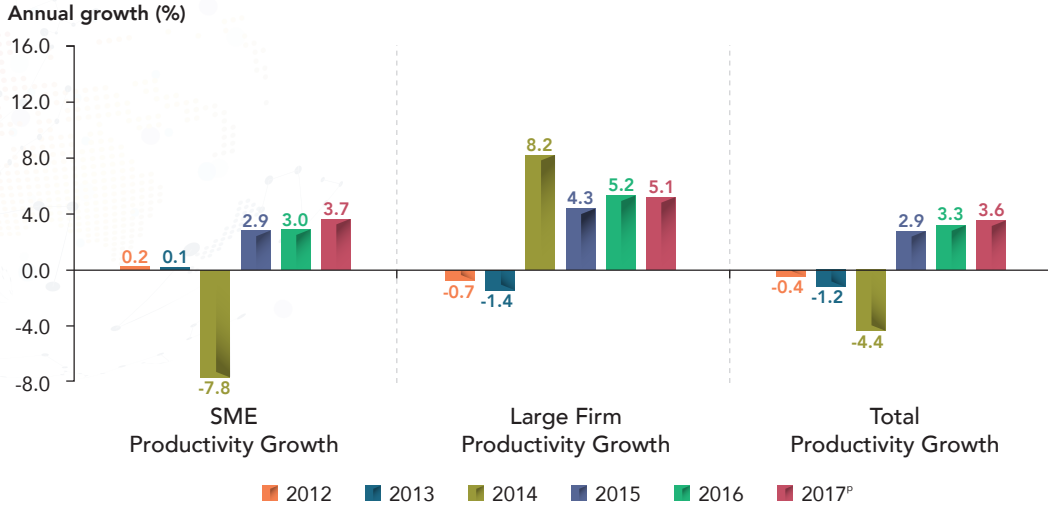


Note: Calculation of employment estimated from various establishment surveys

Source: Department of Statistics, Malaysia

Productivity of SMEs

Chart 2.13: Productivity Growth by Firm Size (%)



Note: Calculation of productivity by SME Corp. Malaysia

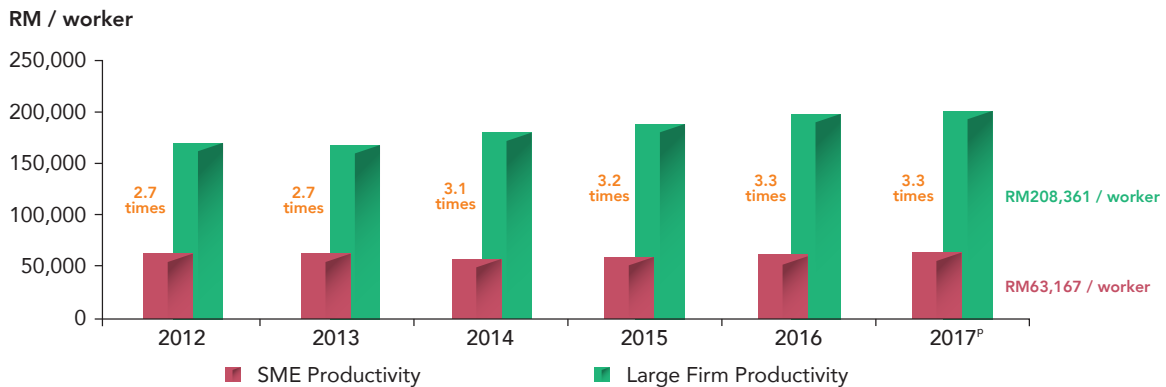
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Source: Department of Statistics, Malaysia

Labour productivity of SMEs as measured by real value-added per worker continued to improve by **3.7%** in **2017** (2016: 3.0%), with a value of **RM63,167** as compared to RM60,887 in 2016 (refer to Chart 2.14). The growth in productivity was attributed by the strong productivity growth in the mining & quarrying (11.9%) and services (6.0%) sectors during the year.

Nevertheless, the productivity gap between SMEs and large firms has remained at 3.3 times since 2016. This is mainly due to gains in productivity of large firms that were supported by higher investment in capital and greater participation from high-skilled workers.

Chart 2.14: Productivity of Firms by Size



Note: Calculation of productivity by SME Corp. Malaysia

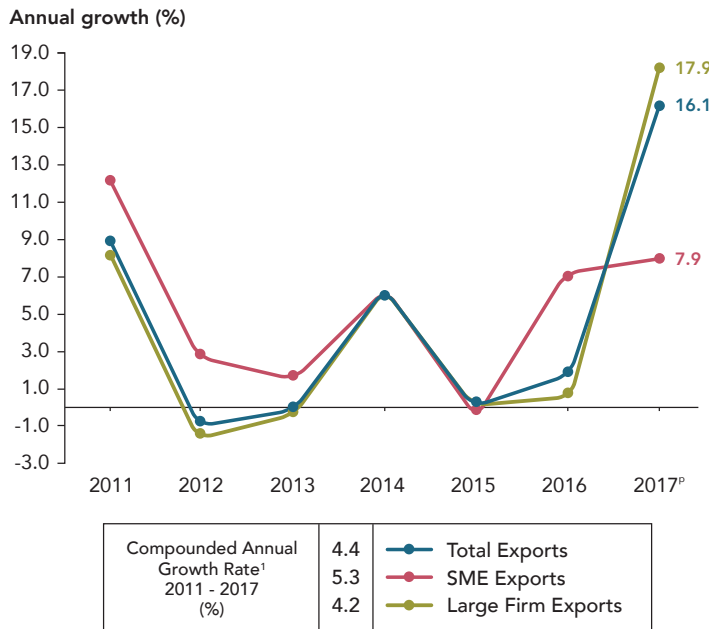
p: preliminary

Source: Department of Statistics, Malaysia

Exports of SMEs

One of the key highlights in year 2017 was the rebound in the performance of total exports as global demand strengthened following the upswing in the global technology cycle, investment expansion in the advanced economies and the turnaround in commodity prices. The materialisation of positive spillovers from the external trade further reinforced SME exports by recording its highest growth rate since 2011.

Chart 2.15: Exports Growth by Size (%)



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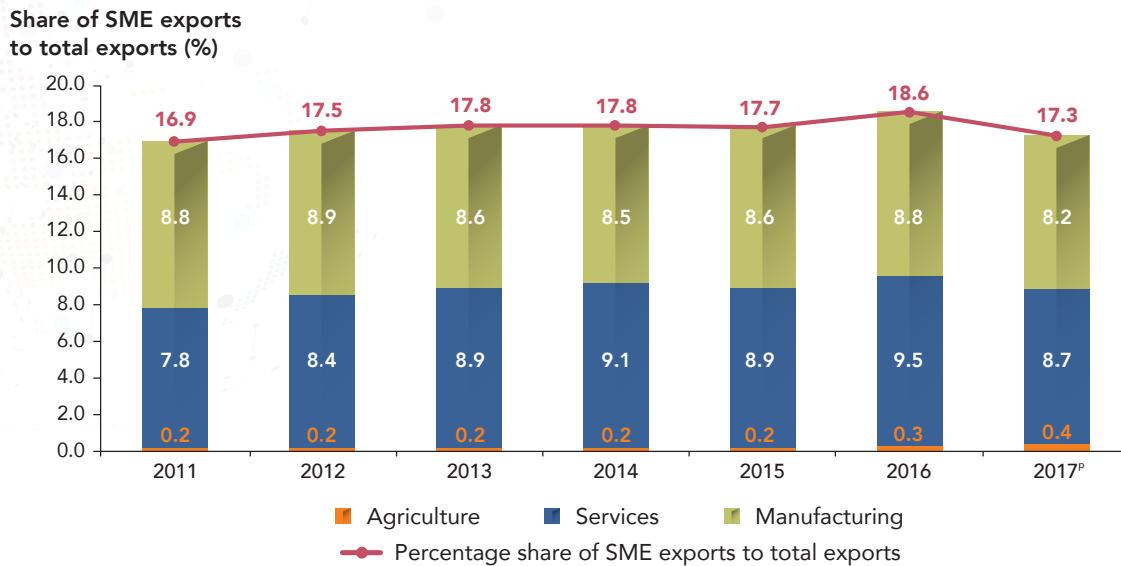
Source: Department of Statistics, Malaysia



In 2017, SME exports registered a higher growth of **7.9%** in **2017** compared to 7.0% in 2016 (refer to Chart 2.15), driven by growth in the agriculture (48.1%), manufacturing (7.8%) and services (6.7%) sectors. The double-digit exports growth performance of SMEs in the agriculture sector was attributed mainly by higher exports in banana, pineapple, poultry and commodity-related production, such as palm oil and rubber. Meanwhile, exports of SMEs in the manufacturing sector which contributed 47.2% to total SME exports in 2017 was supported by growth expansion in mineral fuel, inedible crude materials, animal, vegetable oil & fats products and lubricants & related materials. The **major exports destinations** for SMEs in the manufacturing sector were Singapore which accounted for 18.3%, followed by PR China (9.2%) and United States (US) (7.6%). In the services sector, the growth of SME exports moderated as exports of travel, transport and other business services which accounted the bulk of total SME services exports (96.2%) grew at a slower pace in 2017.

In terms of percentage share, the contribution of SME exports to total exports during the year was lowered at **17.3%** (2016: 18.6%) (refer to Chart 2.16). This is mainly due to the robust exports by large firms which registered a double-digit growth of 17.9%, driven by higher manufactured exports, namely electrical & electronics and petroleum-related products, including liquefied natural gas and crude oil. Thus, large firms benefited significantly from the upturn in global economic growth and trade activity.

Chart 2.16: Percentage Share of SME Exports by Economic Sector (%)



Note: Figures may not necessarily add up due to rounding

p: preliminary

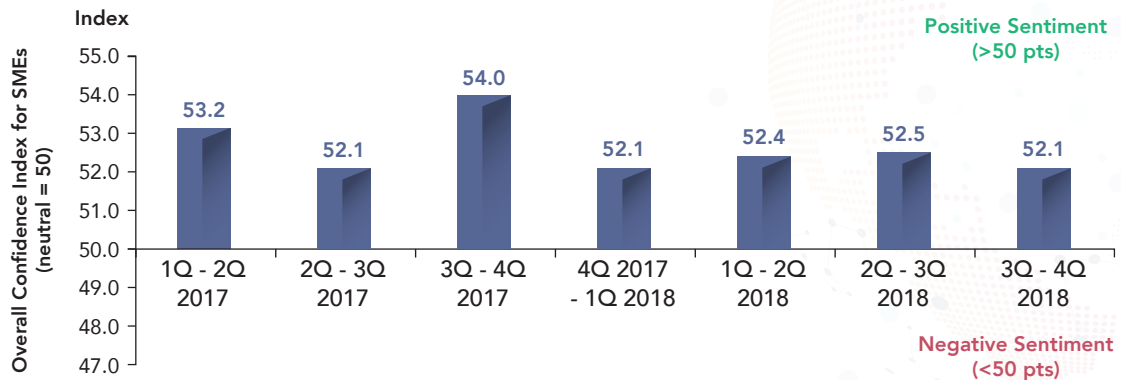
Source: Department of Statistics, Malaysia

OUTLOOK FOR SMEs IN 2018

In 2018, against the expectations of continued expansion in global growth and sustained growth momentum of the Malaysian economy, optimism seems to be on the rise for SMEs in Malaysia. The outlook on positive performance is reflected in the latest survey on RAM Business Confidence Index (3Q - 4Q 2018). In this Survey (refer to Chart 2.17), SMEs remained upbeat about their prospects for the next six months whereby SMEs' turnover and profitability indicators continued their stable trend, improving for third consecutive times. SMEs were also noticeably more optimistic on their performance outlook post-14th General Election (GE14) due to the expectation of higher consumer spending towards the end of the year, resulting from the removal of the Goods and Services Tax (GST) effective 1 June 2018 for three months until the Sales and Services Tax (SST) was reintroduced in September 2018.



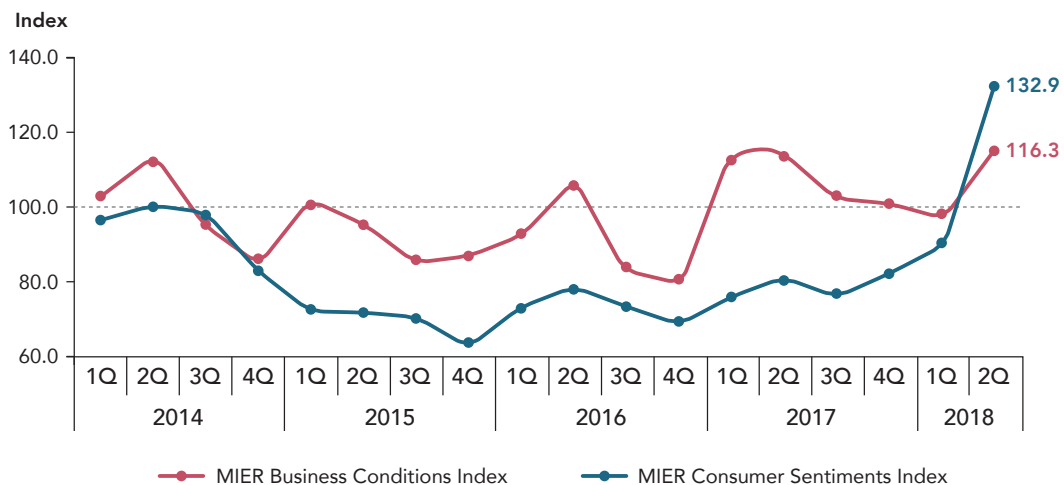
Chart 2.17: RAM Business Confidence Index



Source: RAM Holdings Berhad and RAM Credit Information Sdn. Bhd.

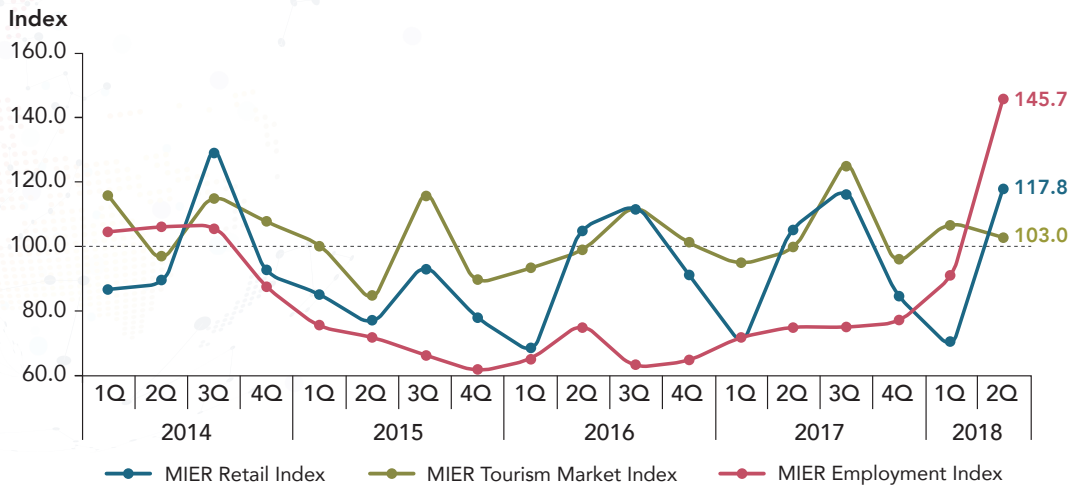
The anticipation of higher private sector spending was also supported by the strong improvements in the Second Quarter of 2018 (2Q 2018) Malaysian Institute of Economic Research (MIER) Consumer Sentiments Index (CSI) and MIER Business Conditions Index (BCI) (refer to Chart 2.18). The MIER CSI increased to its highest level in 21 years to 132.9 points during the period, underpinned by higher level of disposable income due to the abolition of GST, expectations of improvement in consumers' economic welfare and favourable employment outlook. Similarly, businesses were also upbeat about the economy as the BCI increased to 116.3 points, the highest level since the first quarter of 2012, indicating renewed confidence and hope in the new Government that will spur business activity and improve demand conditions. Other MIER's indices, particularly Employment Index and Retail Trade Index also breached the 100-point optimism threshold as depicted in Chart 2.19.

Chart 2.18: MIER Indices: Business Conditions Index and Consumer Sentiments Index



Source: Malaysian Institute of Economic Research

Chart 2.19: MIER Indices: Retail Trade Index, Tourism Market Index and Employment Index

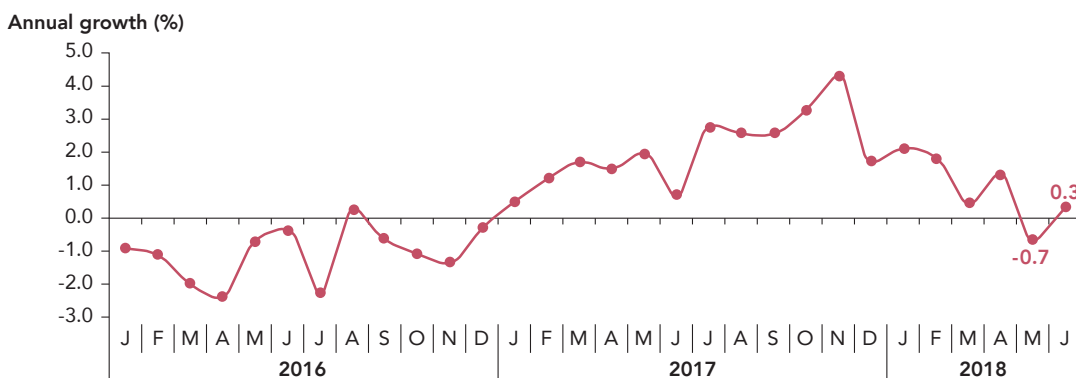


Source: Malaysian Institute of Economic Research

In line with the surveys conducted by RAM and MIER, the latest First Half of 2018 (1H 2018) FMM-MIER Business Conditions Survey showed that the business conditions outlook for manufacturing sector in Malaysia was positive in the second half of 2018 as sales production volume, hiring of workers, cost and capacity utilisation were expected to be improved.

Moreover, Department of Statistics, Malaysia's Leading Index recorded a flat growth of 0.3% in June 2018 compared to negative growth of 0.7% in the previous month. The latest reading indicated that Malaysian economy as a whole will continue to expand albeit at a slower pace in the next four to six months.

Chart 2.20: DOSM Leading Index (%)



Source: Department of Statistics, Malaysia

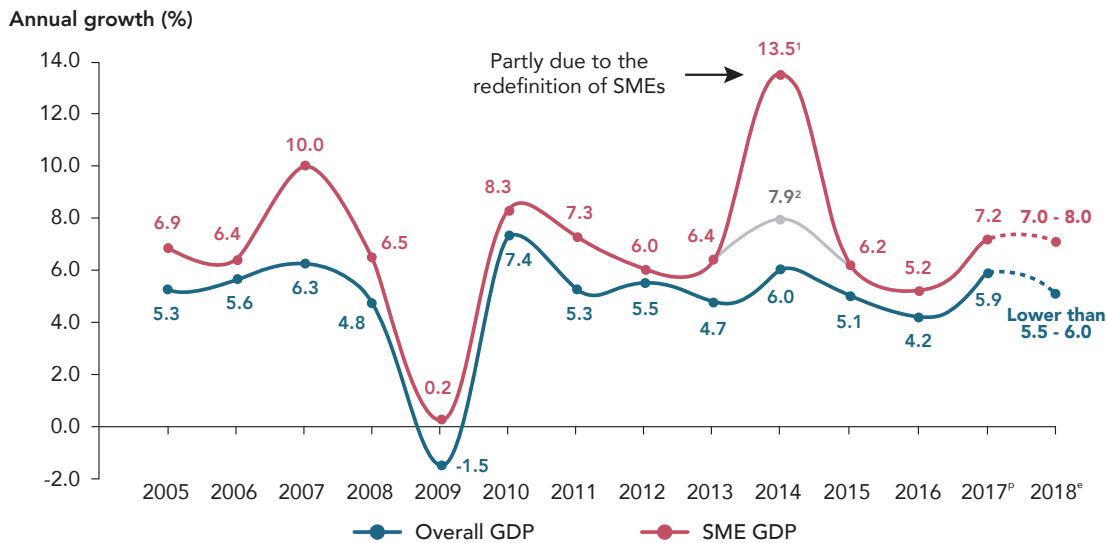
Looking at the medium-term outlook, majority of CEOs in small and mid-sized firms indicated in the Third Quarter of 2018 (3Q 2018) Vistage-MIER CEO Confidence Index that they are confident about current state of the economic condition in Malaysia and expected it to become better in the next 12 months. The index rose to 107.1 points, its highest level since second quarter of 2011.

Similarly, the Nikkei Malaysia Manufacturing Purchasing Managers' Index (PMI) in August 2018 indicated that the level of business sentiment towards the next 12 months for output strengthen to a four-month high, with confidence rooted in positive forecasts of sales and an expected improvement in demand conditions.

Despite the optimistic outlook especially post-GE14, SME growth performance will continue to be influenced by challenges in the global and Malaysian economy. On the **global front**, the anticipation of a faster pace of US interest rate normalisation in 2018, further inward-looking trade policies, sharper-than-expected growth moderation in PR China and geopolitical risks are expected to linger. These challenges could affect global demand and further dampen the consumer, investor and business sentiments affecting SMEs in Malaysia.

Meanwhile, on the **domestic front**, concerns over the possible impact of removal of GST with the implementation of SST, review of mega infrastructure projects and higher minimum wage could affect business cost and performance of SMEs. The rise of online business including e-commerce marketplace also raised some concerns and challenges to brick-and-mortar stores which are mainly SMEs. Assessment on information and communication technology (ICT) adoption among SMEs and challenges faced by SMEs in digital transformation is described in the Box Article on 'Digitalisation Survey of SMEs in 2018'.

Chart 2.21: Growth Projections of SME GDP and Overall GDP (%)



¹ Growth based on 2014 New SME Definition versus 2013 Old SME Definition

² Growth based on 2014 New SME definition versus 2013 New SME Definition

p: preliminary e: estimate

Source: Department of Statistics, Malaysia and SME Corp. Malaysia

In 2018, on the **outlook of SMEs performance**, SME GDP growth is expected to expand at the **lower-end** of the **official estimated range of 7.0 - 8.0%** (refer to Chart 2.21). This estimation is based on actual overall GDP growth performance in the first half of 2018 at 4.9% and the downward revision by BNM on the overall annual GDP growth projection to 5.0% during the second quarter of 2018 GDP press conference, below the official overall GDP growth projection of 5.5 - 6.0% in 2018 announced earlier.