Section 1

Economic Assessment

Chapter TWO

SME Developments and Outlook

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SME Developments and Outlook

Against the backdrop of a challenging economic environment in 2018, SMEs in Malaysia act as stabilisers of growth by demonstrating their ability to withstand external shocks and domestic developments. Growth of SME GDP increased by 6.2% in 2018 (2017: 7.1%) and continued to outperform the overall GDP growth of 4.7% in 2018 (2017: 5.7%). The higher growth was supported by expansion in all economic sectors. In terms of economic contribution, SMEs contributed 38.3% to overall GDP, 17.3% to total exports and 66.2% to total employment during the year.

Outlook for SMEs in 2019, however depends largely on external developments given the current concerns on prolonged trade tensions and softening domestic economic growth. Barring any unexpected developments, SME GDP growth is projected to expand at a moderate pace of 5.8% in 2019. The projection takes into account the actual overall GDP growth performance in the first half of 2019 at 4.7% and official overall GDP growth projection of 4.7% for 2019. Hence, the focus in the National Entrepreneurship Policy 2030 (*Dasar Keusahawan Nasional*, DKN 2030) launched by the Ministry of Entrepreneur Development in July 2019 would be to unleash the untapped potential of SMEs to enable the quantum leap in growth and thus increase the contribution of SMEs to the economy.

GLOBAL AND REGIONAL DEVELOPMENT OF SMEs

SMEs accounted for 99% of all businesses across the Organisation for Economic Co'operation and Development (OECD) countries and contributed between 50-60% of value added. Typically, SMEs operate in services sector with lower entry costs and resource requirements, particularly wholesale & retail trade and construction. There are relatively fewer SMEs in manufacturing sector, notably those that are capital or knowledge-intensive, requiring a larger scale of production. In terms of global market condition of SMEs and entrepreneurship, steady improvement has been observed since the 2008/2009 financial crisis, mainly driven by global investments and a rebound in business confidence. Despite recent signs of tightening, bank lending to SMEs has been increasing at a moderate pace across countries reflecting lower demand for traditional bank financing by SMEs that have restored their profit margins, internal financing capacity and improved the business profiles to attract alternative financing sources. At the same time, challenges in accessing finance persist for microenterprises, start-ups and innovative ventures with novel business models.

> "In terms of global market condition of SMEs and entrepreneurship, steady improvement has been observed since the 2008/2009 financial crisis, mainly driven by global investments and a rebound in business confidence."

Against this backdrop, the supply of alternative sources of funding, such as equity crowdfunding (ECF), peer-to-peer (P2P) lending and financial technology (fintech) is expanding strongly and becoming increasingly important in the SME financing landscape. Based on the OECD publication, Financing SMEs and Entrepreneurs 2019: An OECD Scoreboard, SMEs are turning to non-bank financing sources at a faster pace than in the past. Online P2P lending and fundraising activities on ECF platforms increased significantly in 2017, especially in countries with small markets. China, the United Kingdom and the United States continued to have the biggest online alternative finance markets for businesses. Venture capital investments increased in most countries, and the number of SMEs listings expanded by more than 13% in 2017, with total SME market capitalisation increased by 16.7%.

On the regional front, all economies in Asia-Pacific Economic Cooperation (APEC) continued to implement measures under the four priority areas of APEC's Small and Medium Enterprises Working Group (SMEWG) Strategic Plan for 2017 - 2020, namely:

(i) entrepreneurship, innovation and the internet & digital economy;
(ii) market access for SMEs;
(iii) financing for business expansion and capability development; and
(iv) inclusive business ecosystem that supports SME growth.

On-going key initiatives under the SMEWG include:

i) Establishment of APEC MSME Marketplace

An online portal that enables SMEs in APEC member economies to participate in the directory of exporters, obtain regular updates on various procedures and regulations on international trade as well as participate in business networking and matching activities

ii) Implementation of the APEC Strategy for Green Sustainable and Innovation

Organisation of a Brainstorming Workshop Towards an APEC Green Road: Promoting Responsible and Sustainable Tourism in MSMEs in Thailand

iii) Continuous sharing of best practices among the member economies at the SMEWG meetings held in 2018 and 2019

Japan: Formulation of Act on Enhancement of Management of SME to increase productivity of Japanese SMEs

Malaysia: Holistic monitoring and evaluation of SME and entrepreneurship programmes mechanism

Australia: Improving payment terms for small business whereby the Government will pay invoices within 20 days compared to 30-80 days previously

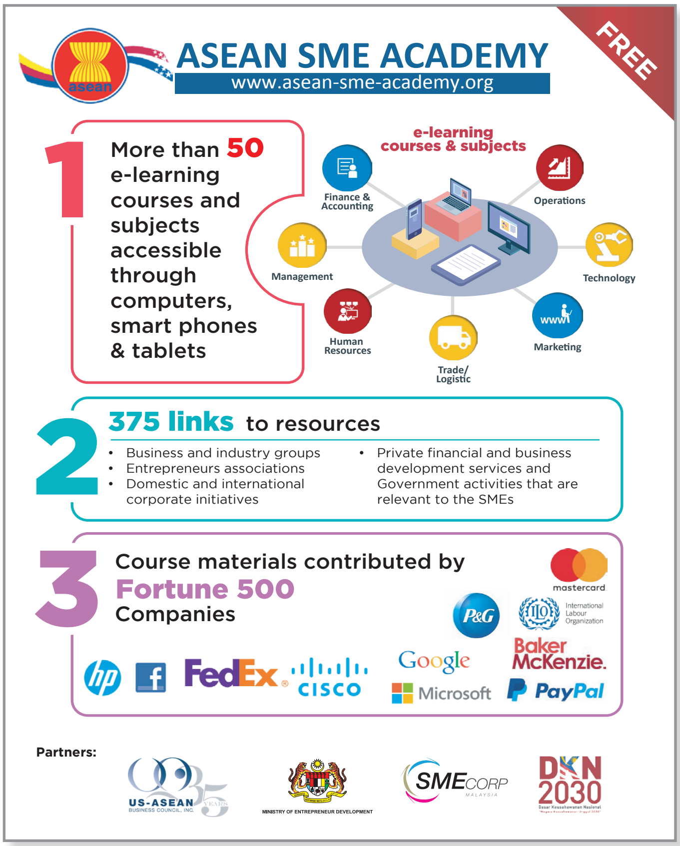
iv) Organisation of various conferences and workshops

Promote a sustainable and inclusive e-commerce ecosystem, digitalisation and internationalisation of SMEs

In line with the SMEWG Strategic Plan's priorities areas particularly on entrepreneurship, two project proposals from Malaysia, namely APEC Young Entrepreneurs Kick-Off and APEC Policy Dialogue on SMEs and Entrepreneurship Framework: Let's be Coherent and Cohesive were endorsed at the 48th SMEWG Meeting held in China in May 2019. The implementation of these projects will be carried out in 2020, in conjunction with Malaysia hosting the APEC 2020.

Association of Southeast Asian Nations (ASEAN) has also been giving strong emphasis to SMEs and Entrepreneurship development agenda through the ASEAN Coordination Committee for Micro Small and Medium Enterprises (ACCMSME), significant progress has been made in relation to the ASEAN Strategic Action Plan for SME Development (SAPSMED 2016 - 2025), particularly on the completion of several priority deliverables for year 2018.

These include endorsement and launch of ASEAN SME Policy Index (ASPI) 2018 Report (detailed findings is featured in Box Article in Chapter 3 on page 63), completion of study on SME Participation in the Digital Economy in ASEAN, development of ASEAN Mentorship for Entrepreneurs Network (AMEN) and completion of two forums on inclusive business. In addition, to mark the effort by the ASEAN Coordinating Committee on Micro, Small and Medium Enterprises (ACCMSME) to promote productivity, technology, digitalisation and innovation for MSMEs, the ASEAN SME Academy was developed in the year. The ASEAN SME Academy is a self-help and self-paced online learning tool for MSMEs, offering free courses and resources on topics such as financing, accounting, management, marketing and technology to help ASEAN MSMEs to grow.



Given that digitalisation is one of ACCMSME's priorities in 2019, the Office of SMEs Promotion Thailand (OSMEP) with the support of Canada through the Canada-OECD Project for ASEAN SMEs organised the Global Digitalisation Model for Micro Enterprises Workshop in May 2019 and a policy dialogue on Starting a Business in ASEAN: Formalisation of Micro Enterprises and How Digitalisation Can Support It in June 2019 in Thailand. The key findings and conclusions from both initiatives will be compiled in the Policy Guideline on Digitalisation of ASEAN Micro Enterprises that among others will propose policies to encourage entrepreneurs to formalise and apply digital solutions for the benefits of their businesses.

In recognising the importance and contribution of women entrepreneurs, the ASEAN-Japan Centre (AJC) organised the 3rd ASEAN-Japan Women Entrepreneurs' Linkage Program (AJWELP) from 27-30 January 2019 in Kuala Lumpur, Malaysia. The Programme, co-hosted by SME Corp. Malaysia, successfully linked the start-up women entrepreneurs across ASEAN region with participating companies, mentors and a circle of supporters, as well as expanded their skills in entrepreneurship and leadership. A total of 24 women entrepreneurs benefitted from the programme which saw four mentors from ASEAN member states and Japan imparting their knowledge and experience during the programme. The networking also resulted in potential business and investment ventures among those involved.

PERFORMANCE OF SMEs IN MALAYSIA

Overview: Growth Trends of SMEs in 2016 - 2018

The revised time series data from the Department of Statistics, Malaysia (DOSM) based on Gross Domestic Product (GDP) at constant 2015 prices showed that the SME GDP grew at an **average annual growth rate** of **6.2%** in the period of **2016 - 2018**, higher than the average annual growth rate of overall GDP of 5.0%. The same trend can be seen since 2004, of which the GDP growth of SMEs has consistently outperformed the overall economic growth. The contribution of SMEs to the overall GDP has increased from 37.0% in 2015 to **38.3%** in **2018**.

Table 2.1: SME GDP by Economic Sector (constant 2015 prices)

	SME Contribution to Overall GDP			SME GDP Growth
	2015 (% share)	2018 (% share)	Increase / decrease in share	CAGR[1] 2016 - 2018 (%)
Overall[2]	**37.0**	**38.3**	**+1.4**	**6.2**
Services	22.4	23.9	+1.5	7.3
Mining & Quarrying	0.2	0.2	0.0	7.1
Manufacturing	7.5	7.7	0.2	5.7
Construction	2.2	2.3	0.0	5.7
Agriculture	4.2	3.9	-0.4	1.9

[1] CAGR refers to compounded annual growth rate
[2] Total value-added after taking into account import duties
Note: Figures may not necessarily add up due to rounding
Source: Department of Statistics, Malaysia

In terms of performance by economic sectors, the increase in share of SMEs to GDP in the period of 2016 - 2018 was largely contributed by the services sector. This is reflected by the higher average annual growth rates for services sector at 7.3% compared to the average annual growth rate of overall SME GDP of 6.2% (refer to Table 2.1).

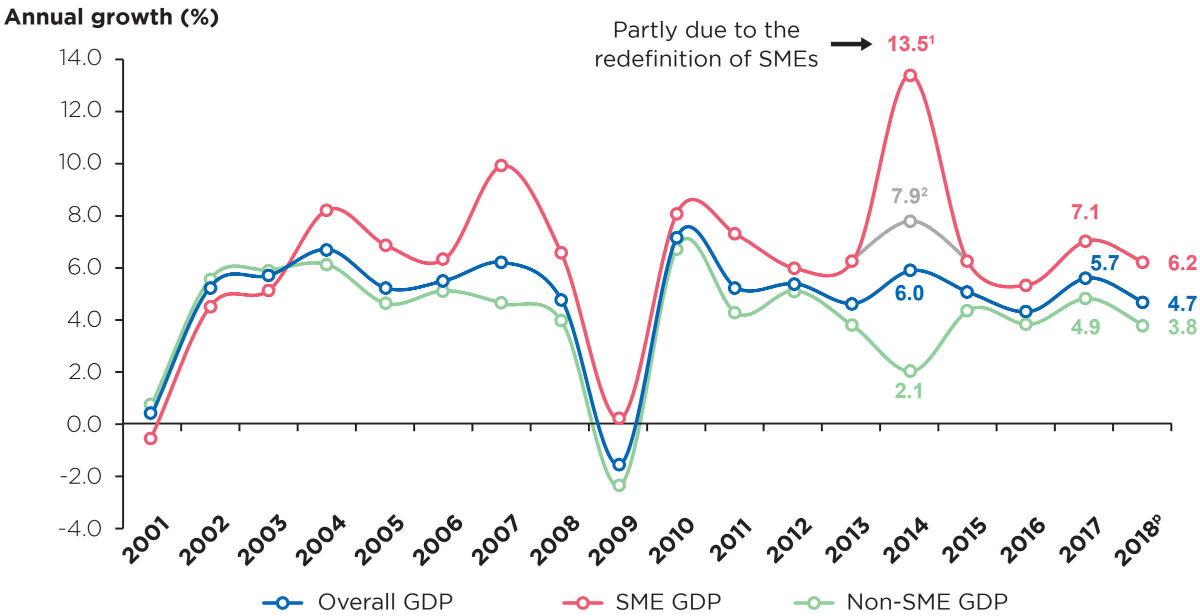
Performance in 2018

SME GDP

SMEs in Malaysia continued to demonstrate their resilience by recording a growth of 6.2% in 2018 (2017: 7.1%), slightly above the long-term average growth of 6.0% (2001 - 2017), despite a challenging global and domestic economic environment. This performance exceeded overall GDP and non-SME GDP which registered 4.7% and 3.8% in 2018 respectively as shown in Chart 2.1. The higher growth of SME GDP indicated that the SMEs were not adversely affected and able to withstand external shocks, such as unresolved trade tensions between the United States and PR China and slower global growth, considerably well. This is mainly due to the fact that majority of SMEs are domestic driven and proven to be more resilient than the large firms.

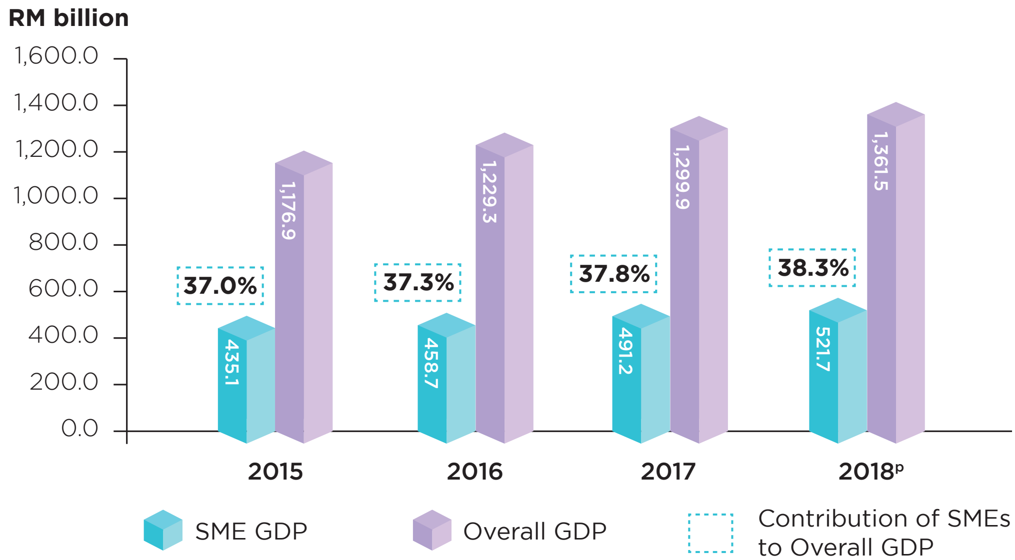
In terms of value, SME GDP has been realigned with the rebasing of overall GDP to base year 2015 from year 2010. Rebasing of GDP is a normal statistical procedure performed by National Statistical Offices in most countries including Department of Statistics, Malaysia to ensure the statistics reflect the current economic structure. Hence, in 2018, SME GDP at constant 2015 prices increased to RM521.7 billion as compared to RM491.2 billion in 2017, resulting in higher contribution of SMEs to overall GDP to 38.3% in 2018 as compared to 37.8% in the previous year (refer to Chart 2.2).

Chart 2.1: SME GDP, Non-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

Chart 2.2: Value of SME GDP and Overall GDP at Constant 2015 Prices



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

In 2018, SMEs in all economic sectors except services sector expanded at a more moderate pace compared to the previous year. The growth in services sector increased by 8.1% (2017: 7.2%) as better consumer sentiments and favourable labour market conditions spurred spending. When compared between the overall economy and SMEs, the SME GDP grew at a faster pace across all economic sectors except construction sector (refer to Table 2.2).

ENTREPRENEURSHIP DRIVING SMEs

Table 2.2: SME GDP and Overall GDP Growth by Economic Sector (constant 2015 prices)

	2017 SME GDP	2018 SME GDP	2018 Overall GDP
	Annual growth (%)		
Services	7.2	8.1	6.8
Manufacturing	6.8	5.5	5.0
Mining & Quarrying	8.9	4.3	-2.6
Construction	6.6	4.0	4.2
Agriculture	6.0	0.3	0.1
Total	**7.1**	**6.2**	**4.7**

Source: Department of Statistics, Malaysia

In terms of sectoral contribution, the two largest contributors to the SME GDP in 2018 were the services sector with a share of 62.4% and manufacturing sector (20.1%) as depicted in Table 2.3. The combined share of these two sectors was 82.4% of the SME GDP. The agriculture sector contributed 10.1% to SME GDP followed by the construction and mining & quarrying sectors which contributed 5.9% and 0.5% respectively.

The structure of SME GDP is almost similar to the overall GDP structure with the exception of mining & quarrying sector. As shown in Table 2.3, mining & quarrying sector contributed 0.5% to total SME GDP as compared to 7.6% to overall GDP. This was due to structural differences whereby SMEs in mining & quarrying sector were dominated by activities in other mining & quarrying and supporting services. While crude oil & condensate and natural gas sub-sectors were the major contributors for mining & quarrying sector of overall GDP.

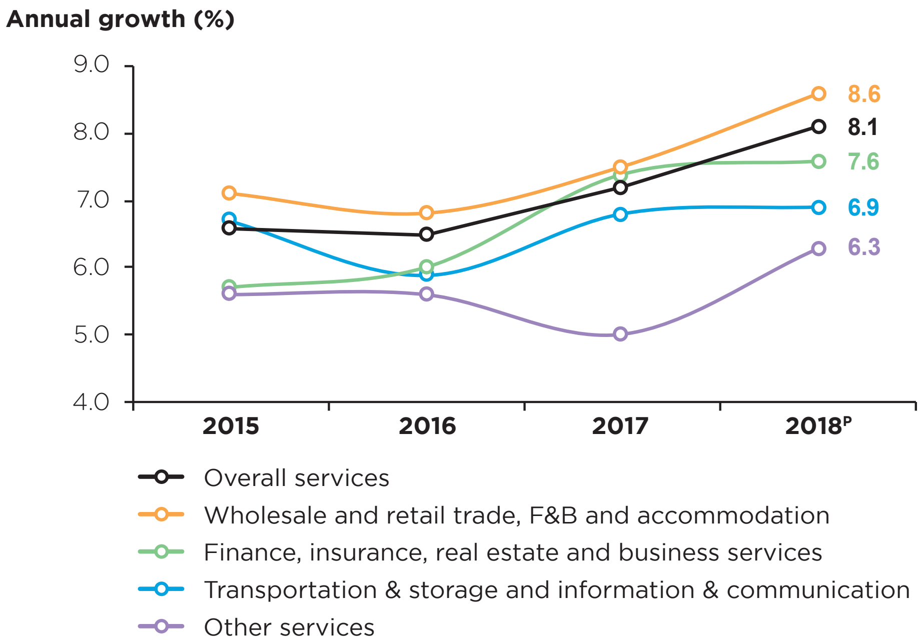
Table 2.3: SME GDP and Overall GDP Share by Economic Sector in 2018 (constant 2015 prices)

	2018	
	SME GDP	Overall GDP
	Percentage Share to Total (%)	
Services	62.4	56.7
Manufacturing	20.1	22.4
Agriculture	10.1	7.3
Construction	5.9	4.9
Mining & Quarrying	0.5	7.6
Plus: import duties	1.1	1.2
Total	**100**	**100**

Notes: Figures may not necessarily add up due to rounding
Source: Department of Statistics, Malaysia

SME Value-added in the Services Sector

Chart 2.3: SME Value-added Growth of Sub-sectors in the Services Sector (%)



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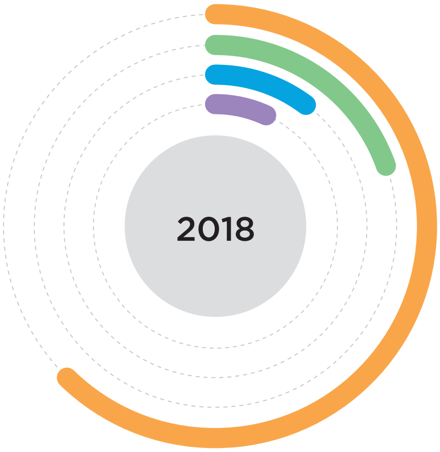
Source: Department of Statistics, Malaysia

SME value-added in the **services sector** registered a stronger growth of 8.1% in 2018 (2017: 7.2%), the highest pace since 2014 (refer to Chart 2.3). The growth was driven primarily by wholesale & retail trade, food & beverages and accommodation sub-sector which formed the biggest component of the SME value-added in the services sector (63.9% of total share) as consumer spending improved in particular during the three-month (1 June - 31 August 2018) zerorisation of the Goods and Services Tax (GST) rate period and other Government measures to alleviate cost of living pressures. These measures include fixing of the retail fuel price of RON95 petrol and special payment of RM500 for civil servants and RM250 for Government pensioners. The higher value-added growth of SMEs in the services sector was also supported by finance, insurance, real estate and business services sub-sector which increased by 7.6% (2017: 7.4%), as well as the transportation & storage and information & communication sub-sector which expanded by 6.9% (2017: 6.8%).

Chart 2.4: Components of Value-added of SMEs in the Services Sector (%)



63.9 Wholesale and retail trade, F&B and accommodation

19.4 Finance, insurance, real estate and business services

10.0 Transportation & storage and information & communication

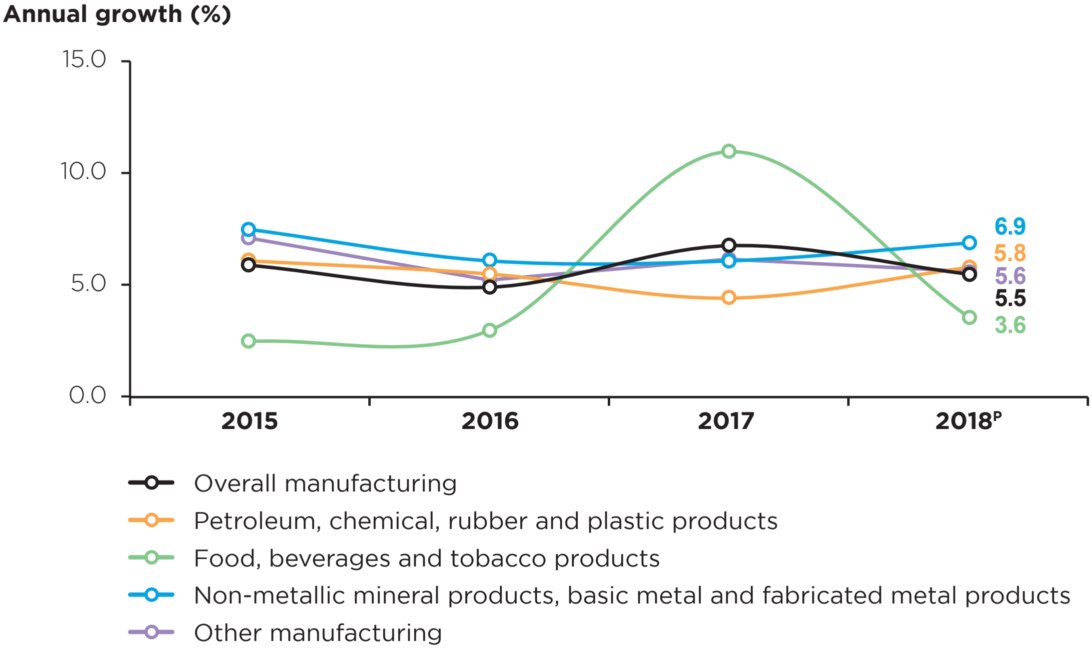
6.8 Other services

Source: Department of Statistics, Malaysia

SME Value-added in the Manufacturing Sector

In **manufacturing sector**, value-added of SMEs expanded by 5.5% (2017: 6.8%), led by non-metallic mineral products, basic metal & fabricated metal products with a growth of 6.9% (2017: 6.1%), supported by the manufacturing of construction-related materials. The petroleum, chemical, rubber and plastic products sub-sector which accounted for 22.8% of total value-added of SME manufacturing sector also contributed to the growth of SME value-added in the manufacturing sector during the year by posting a higher growth of 5.8% in 2018 (2017: 4.4%). Meanwhile, food, beverages and tobacco products sub-sector grew at a slower pace at 3.6% (2017: 11.0%) due to lower manufacturing of beverages (refer to Chart 2.5).

Chart 2.5: SME Value-added Growth of Sub-sectors in the Manufacturing Sector (%)



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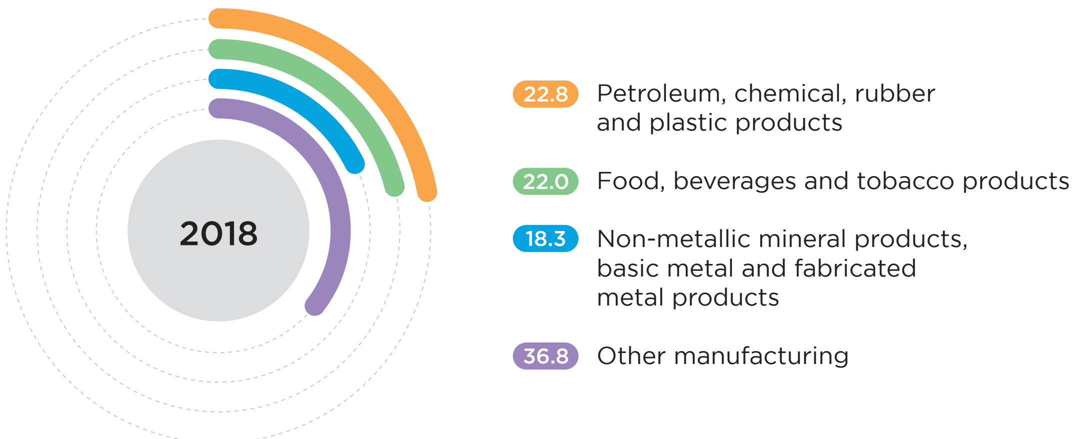
Source: Department of Statistics, Malaysia

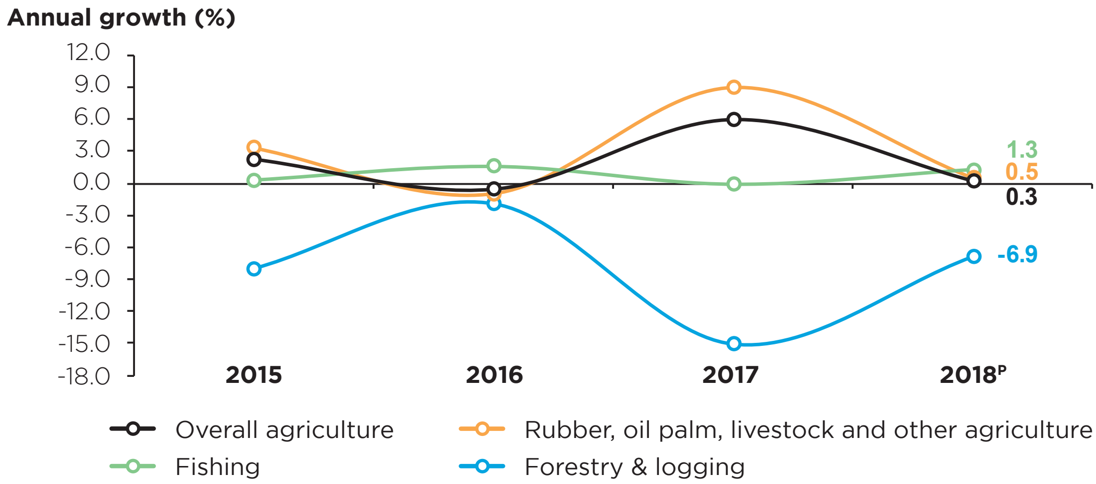
Chart 2.6: Components of Value-added of SMEs in the Manufacturing Sector (%)



Source: Department of Statistics, Malaysia

SME Value-added in the Agriculture Sector

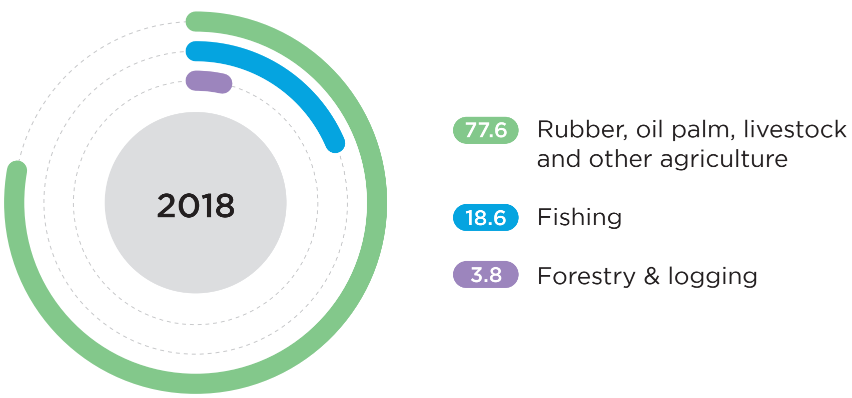
Chart 2.7: SME Value-added Growth of Sub-sectors in the Agriculture Sector (%)



p: preliminary
Source: Department of Statistics, Malaysia

SME value-added in the **agriculture sector** recorded a marginal positive growth of 0.3% in 2018 as compared to 6.0% in the previous year (refer to Chart 2.7). This was mainly due to the slower growth in rubber, oil palm, livestock and other agriculture sub-sector of 0.5% (2017: 9.0%) as adverse weather and production constraints affected the palm oil and rubber production. This sub-sector contributed 77.6% to SME value-added in the agriculture sector. Meanwhile, forestry & logging activities which accounted for 3.8% to total value-added of SME agriculture sector continued to record a decline in value-added growth in 2018.

Chart 2.8: Components of Value-added of SMEs in the Agriculture Sector (%)

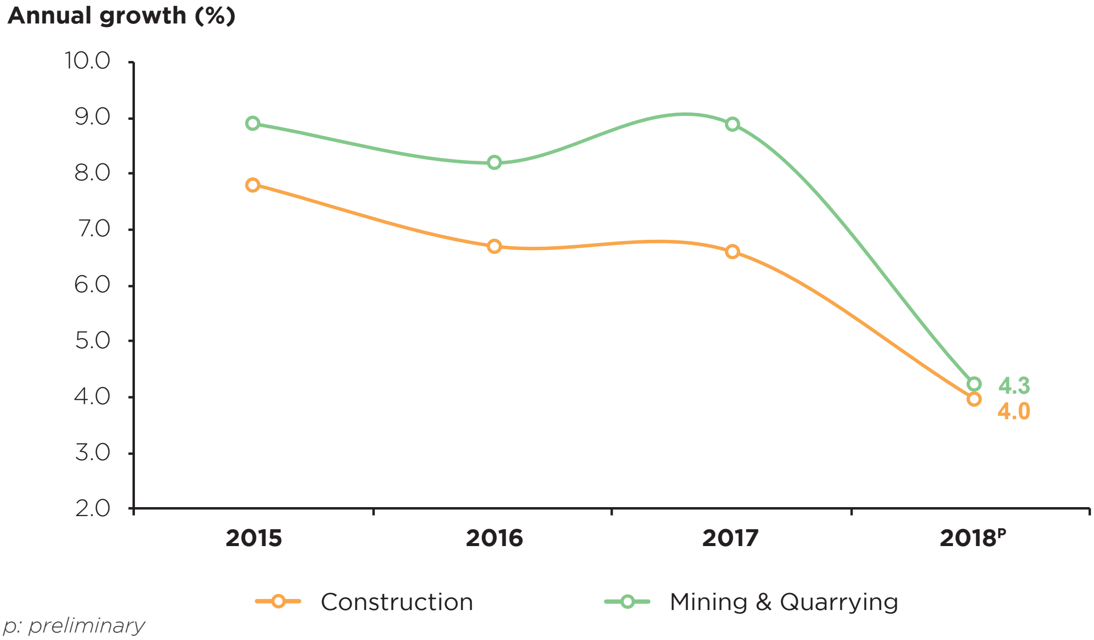


Source: Department of Statistics, Malaysia

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

In line with the moderate growth of overall GDP in **construction sector** in 2018, SMEs in this sector also recorded a moderate value-added growth of 4.0% in 2018 (2017: 6.6%), mainly due to slower activities in special trade sub-sector. The slower growth in residential buildings and non-residential buildings amidst the high number of unsold residential properties and the oversupply in commercial properties have moderated the overall performance of the sector.

Chart 2.9: SME Value-added Growth in the Construction and Mining & Quarrying Sectors (%)



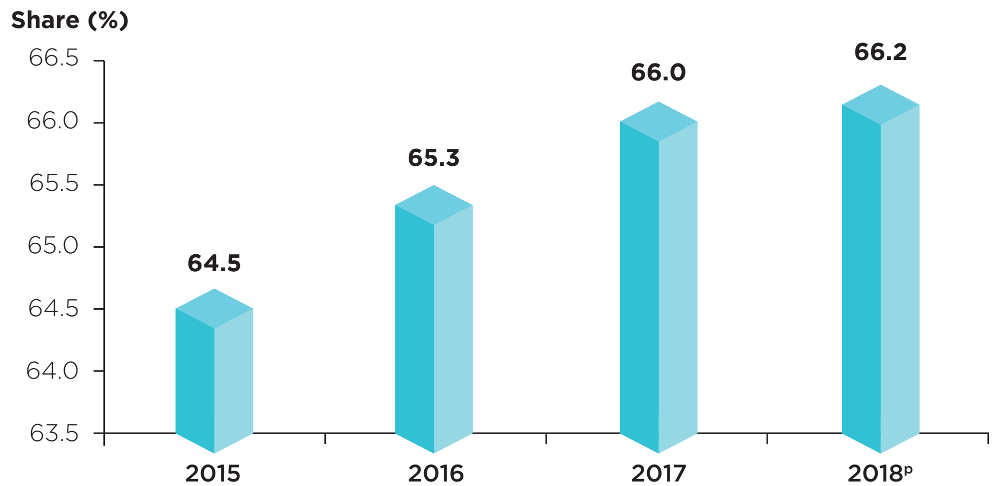
p: preliminary
Source: Department of Statistics, Malaysia

Growth of SME value-added in the **mining & quarrying sector** moderated to 4.3% in 2018 (2017: 8.9%), reflecting slower activities in mineral mining as well as stones, rocks and granite quarrying. This explained by the fact that majority (89.7%) of SMEs in this sector were involved in mineral mining and quarrying activities.

SME Employment

SMEs play an important role in the job creation whereby in 2018, SMEs in Malaysia employed 66.2% of total employment, slightly higher than in the previous year at 66.0% (refer to Chart 2.10). The growth of SME employment sustained at 3.2% during the year (2017: 3.4%), driven by higher employment in services and manufacturing sectors. The increasing trend on shares of employment by the SMEs over time was partly due to provision of conducive ecosystem and policies encouraging self-employment, creation of firms, particularly microenterprises and entrepreneurs. It is also partly due to the fact that the large firms may be taking less new workers or even laying off workers due to economic conditions. From sectoral perspective, majority of SME employment was generated by services sector (62.3%), followed by manufacturing (16.4%), agriculture (10.7%), construction (10.3%) and mining & quarrying (0.3%) (refer to Chart 2.12).

Chart 2.10: Contribution of SMEs to Total Employment (%)



Note: Calculation of employment estimated from various establishment surveys
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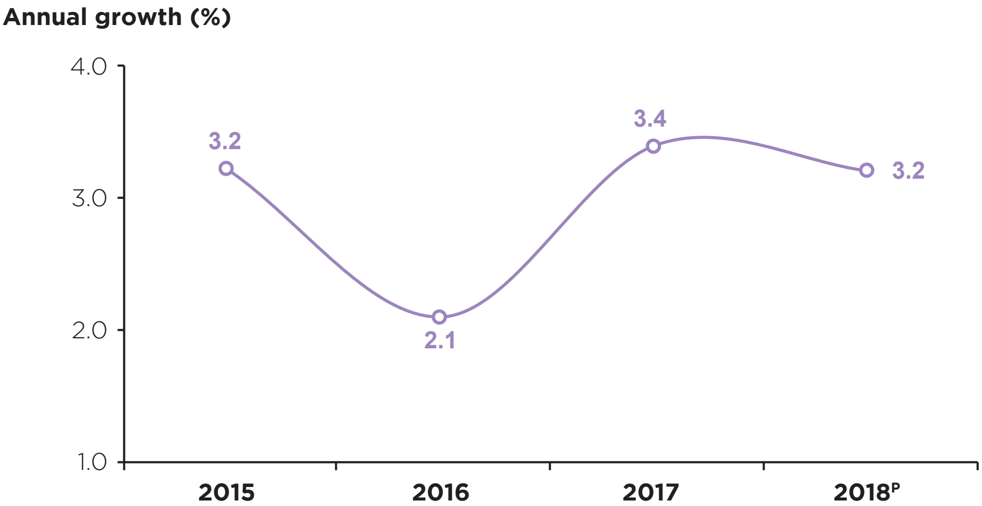
Source: Department of Statistics, Malaysia

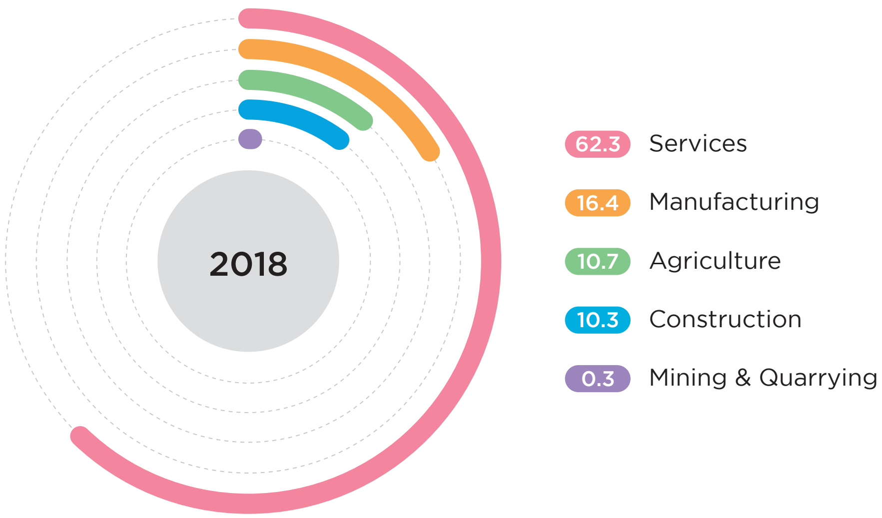
"ENTREPRENEURSHIP DRIVING SMES"

Chart 2.11: SME Employment Growth Performance (%)



Note: Calculation of employment estimated from various establishment surveys
p: preliminary
Source: Department of Statistics, Malaysia

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

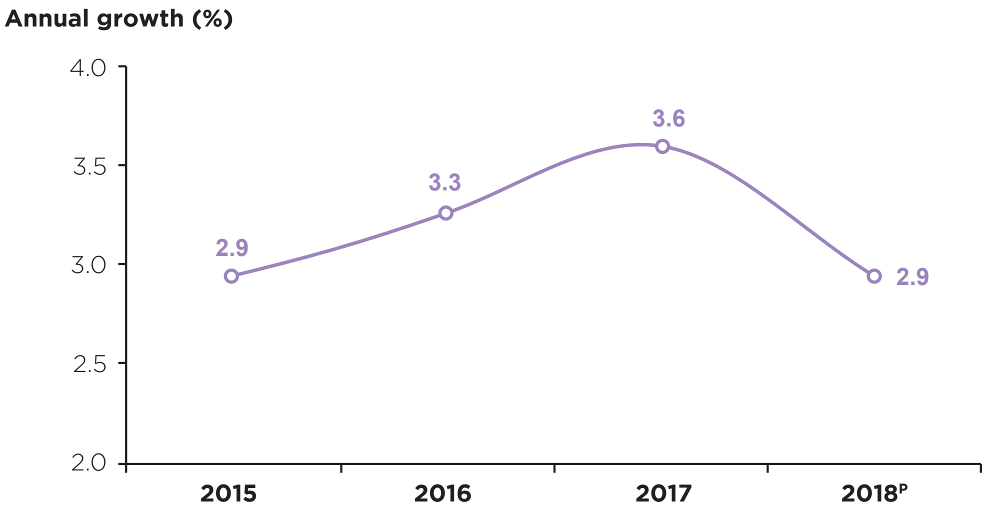


Note: Calculation of employment estimated from various establishment surveys
Source: Department of Statistics, Malaysia

SME Productivity

Labour productivity of SMEs as measured by real value-added per employee improved from RM71,301 in 2017 to RM73,399 in 2018, with a growth of 2.9% (2017: 3.6%) (refer to Chart 2.13). The growth was driven by productivity gains in the mining & quarrying (8.3%), services (3.8%) and manufacturing sectors (3.1%). Several factors, such as lack of scale, managerial skills, innovation, finance and market access are often cited as holding back productivity growth of SMEs. Thus, better management practices can increase productivity not only through enhanced operational efficiency and minimised cost, but also by adopting Fourth Industrial Revolution (IR 4.0) related technologies.

Chart 2.13: SME Productivity Growth (%)



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Source: Department of Statistics, Malaysia

SME Exports

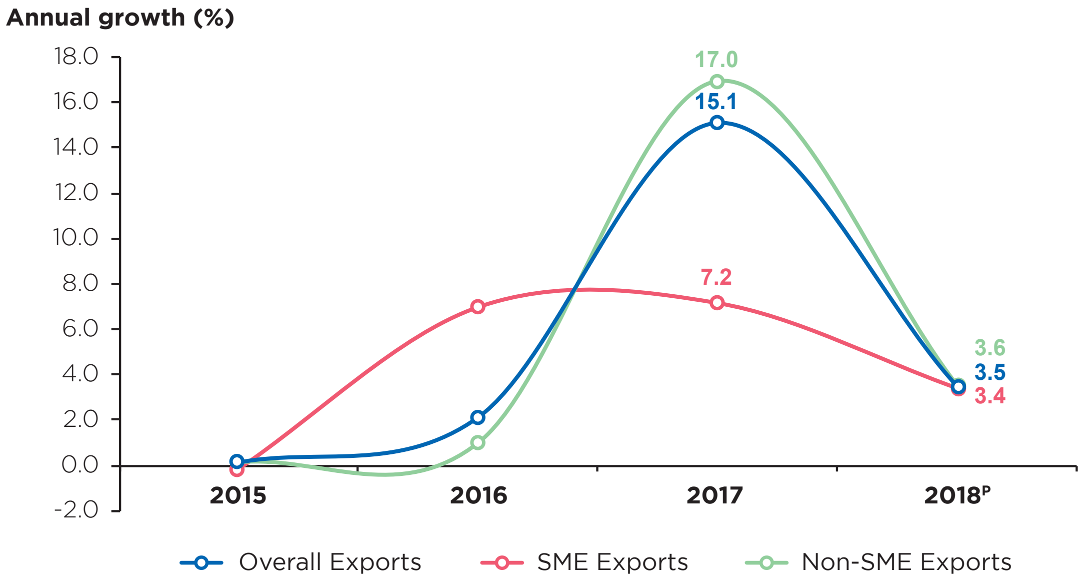
As an economy with a high degree of openness to trade and investment flows, Malaysia was certainly affected by both weakened global GDP and trade growth in 2018. The economy was confronted with several external challenges, among others, escalation of global trade tensions, continued policy uncertainty following the outcome of Brexit negotiations and volatile commodity prices.

Despite the challenges, SMEs were less affected compared to the large firms by the weakness in external demand due to relatively low exposure to the export market. In 2018, SMEs showed a strong resilience by recording a growth of 3.4% in 2018 (2017: 7.2%), while non-SME registered a significant slowdown in growth at 3.6% in 2018 (2017: 17.0%) (refer to Chart 2.14). In value terms, SME exports increased to RM171.9 billion in 2018 from RM166.2 billion in 2017, while the share to overall exports remained at 17.3% (2017: 17.3%) (refer to Chart 2.15). The exports growth momentum was driven by SMEs in the manufacturing sector which contributed 48.3% of total SME exports in 2018, supported by manufactured goods, chemicals products and beverages & tobaccos. The main destinations for SME exports in the manufacturing sector was Singapore which accounted for 18.6%, followed by PR China (8.9%) and the United States (7.8%).

The services sector which accounted for 50.3% of total SME exports, expanded at a more moderate pace of 2.0% in 2018 (2017: 7.1%). The slower growth was due to fewer tourist arrivals during the year which translated to lower exports of travel and other business services. Nevertheless, SME services exports received some support from higher export growth in transport services, such as freight and postal & courier services.

Growth of SME exports in agriculture sector continued to decline by 2.0% (2017: -6.3%) due to lower exports of vegetables, banana, pineapple and other tropical fruits, such as watermelon, guava and others. The major exports destinations for SMEs in the agriculture sector were Singapore, Thailand and Japan. Realising this, enhancing exports by SMEs will be given a special focus going forward and key strategies will be formulated towards strengthening the export capacity and capability of SMEs.

Chart 2.14: SME Exports Growth (%)



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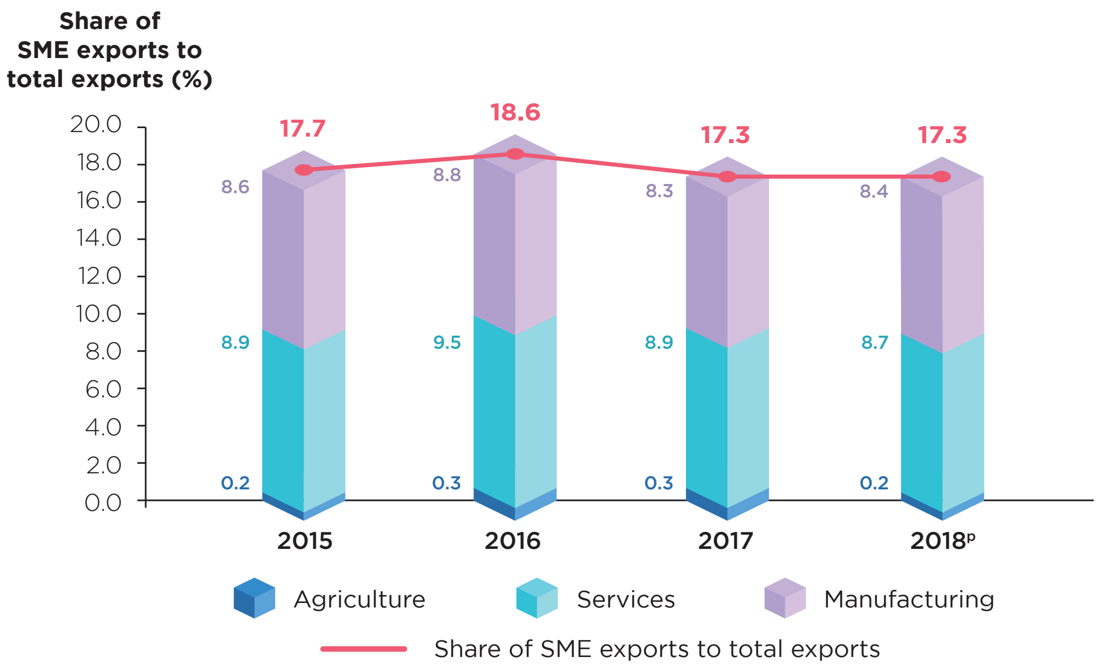
Source: Department of Statistics, Malaysia

Chart 2.15: Share of SME Exports by Economic Sector (%)



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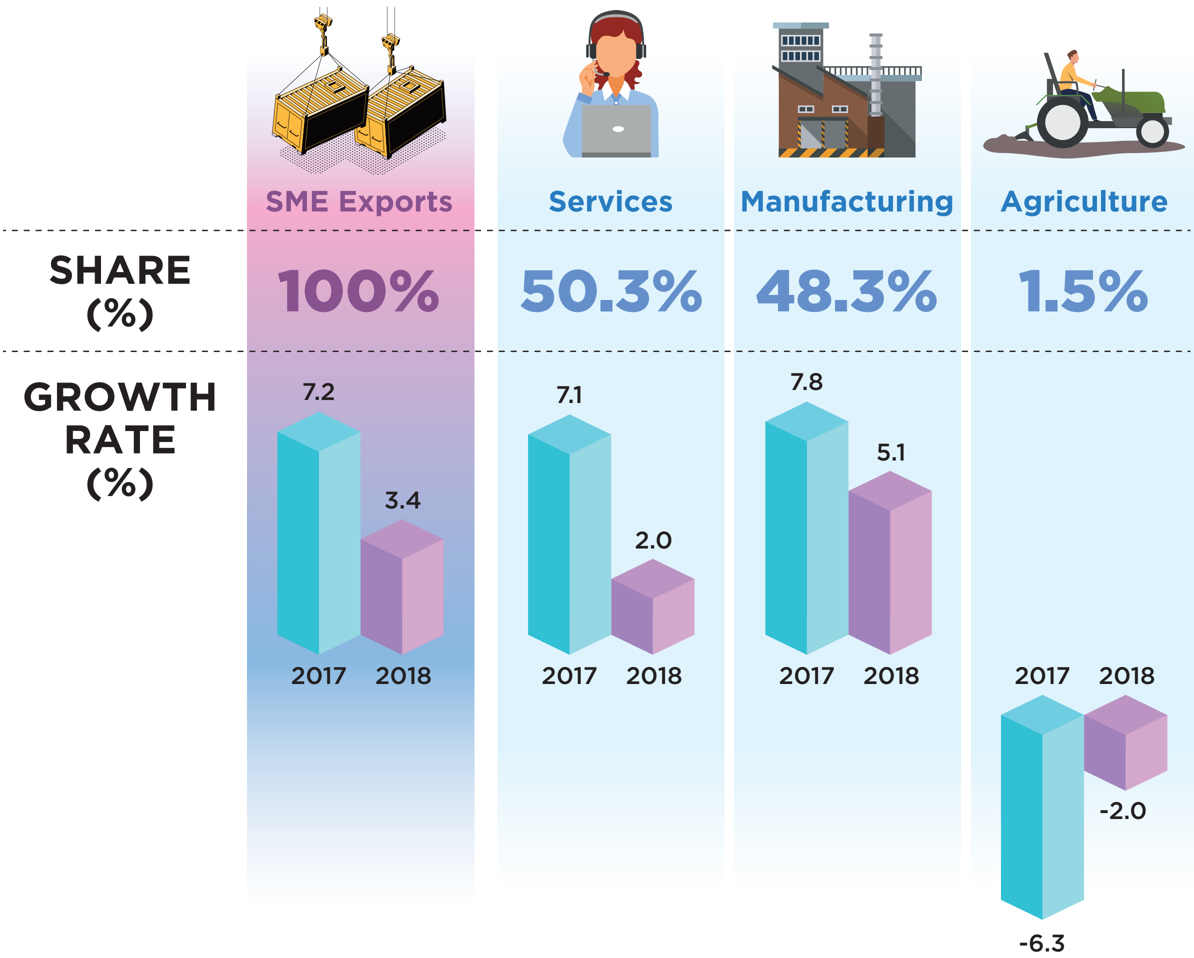
Source: Department of Statistics, Malaysia

Chart 2.16: SME Exports Growth and Component by Economic Sector (%)



Notes: Figures may not necessarily add up due to rounding
Source: Department of Statistics, Malaysia

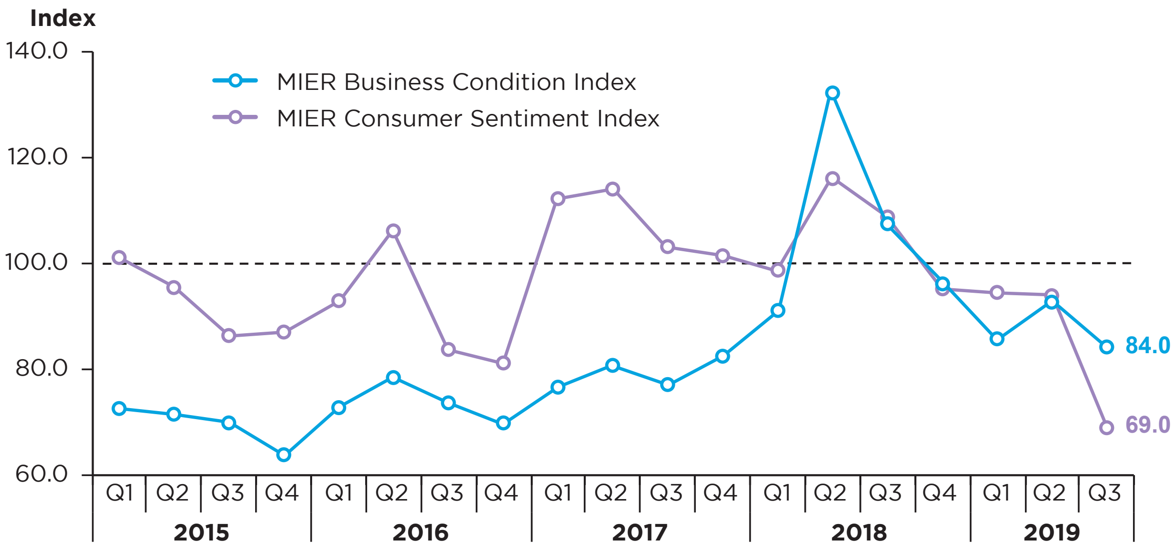
OUTLOOK FOR SMEs IN 2019

The global economy is expected to continue experience slower growth in 2019. Dynamism in the global economy is being weighed down by slowdown in manufacturing activity and global trade following rising trade and geopolitical tensions. Fears of disruptions to technology supply chains, continuous Brexit-related uncertainty and additional United State's tariffs on China's import added to the volatile market sentiment. With global growth subdued and downside risks dominating the outlook, the global economy remains at a delicate juncture.

Against the backdrop of a challenging global environment, the Malaysian economy is expected to sustain its growth momentum, expanding by 4.7% in 2019 (2018: 4.7%). Domestic demand is projected to support the country's growth, underpinned by both private sector consumption and investment amidst the continued moderation in external demand. Nonetheless, some forward-looking indicators are showing cautious underlying tone.

The third quarter of 2019 (3Q 2019) surveys by Malaysian Institute of Economic Research (MIER) showed a less optimistic prospects. Business Condition Index (BCI) slipped further below the 100-point optimism threshold, at 69.0 points (2Q 2019: 94.2 points) which is the lowest level since 2008. Firms are increasingly pessimistic about future business conditions due to further decrease in sales, sluggish production volume and decline in domestic and external orders. Meanwhile, the Consumer Sentiments Index (CSI) also fell below the optimism threshold at 84.0 points (2Q 2019: 93.0 points) which is the lowest reading since 4Q 2017. Consumer sentiments were weighed down by the weak job outlook, less favourable of current finance, anxiety over rising prices as well as limited shopping plans following weak purchasing power.

Chart 2.17: MIER Indices: Business Conditions Index and Consumer Sentiments Index



Source: Malaysian Institute of Economic Research (MIER)

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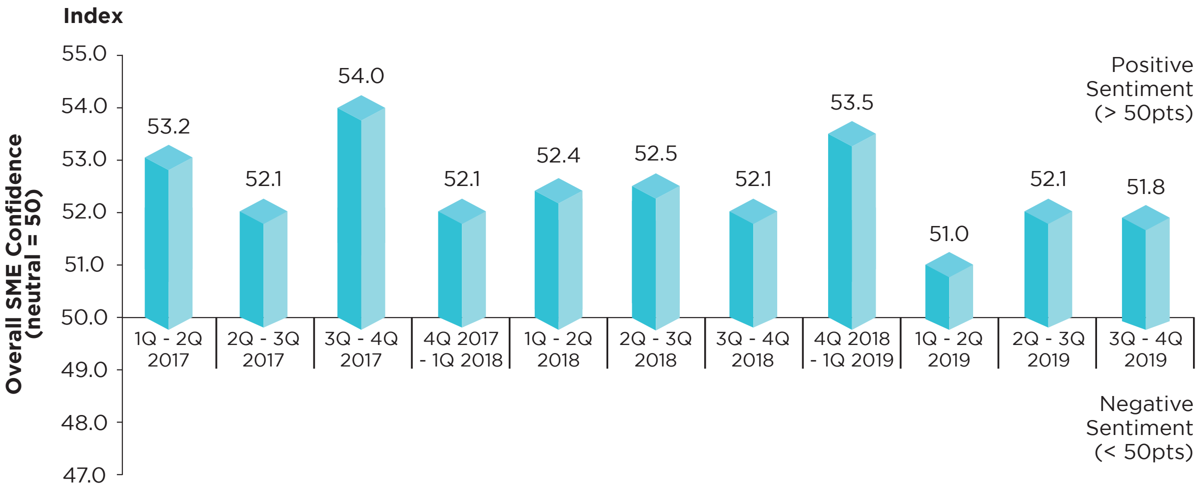
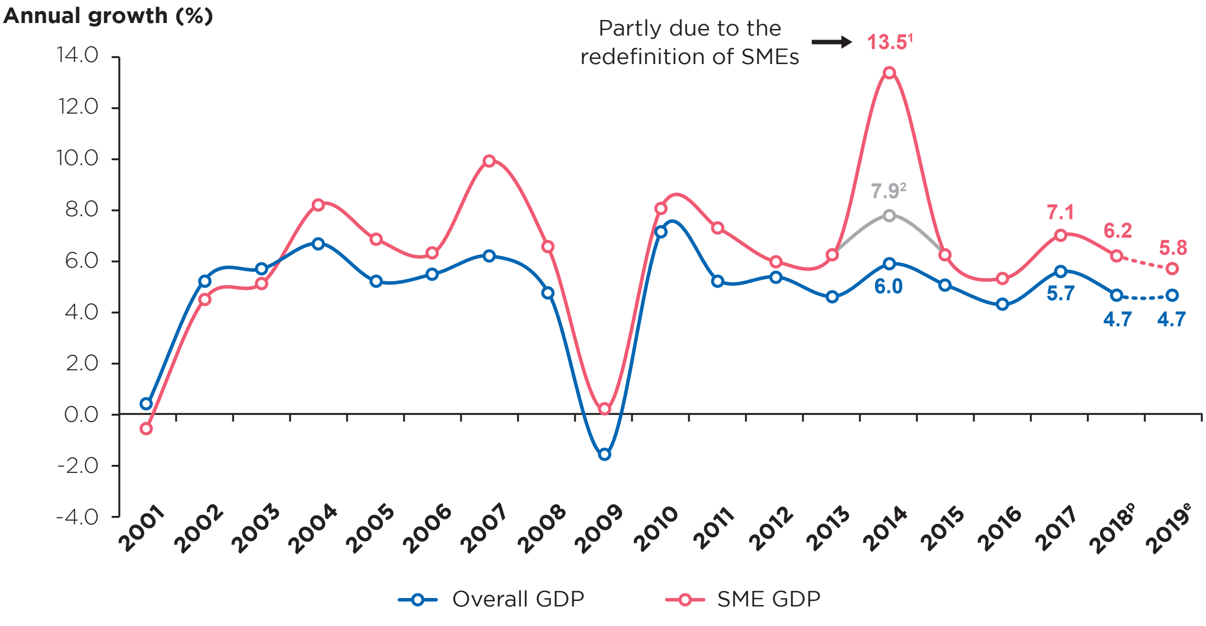
Chart 2.18: RAM Business Confidence Index on SMEs



Source: RAM Credit Information Sdn. Bhd.

Chart 2.19: Growth Projections for 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 terms of business expectation, the latest RAM Business Confidence Index (BCI) 3Q - 4Q 2019 still indicated a subdued level of optimism for the next six months (second half of 2019) whereby the overall BCI index for SMEs slipped to 51.8 points (2Q - 3Q 2019: 52.1 points) (refer to Chart 2.18). The cautiously optimistic sentiment reflected the expectation of weaker sales turnover and profitability sentiment of export-oriented SMEs despite signs of trade diversion benefits from the ongoing US-China trade war. In line with the surveys conducted by RAM and MIER, CEOs in small and mid-sized firms were more cautious lately as global and domestic economic uncertainties continued to cloud both consumer and business sentiments, thus slowing business trajectories from hiring to investment going forward. This is reflected in the latest 4Q 2019 VISTAGE-MIER CEO Confidence Index which stood at 85.3, lower than the prior quarter's at 90.2.

While the overall business outlook was less upbeat in second half of 2019 (2H 2019), findings from ACCCIM Malaysia's Business and Economic Conditions Survey 1H 2019 and 2H 2019F showed that businesses projected their cash flow and sales performance to be slightly better in 2H 2019 when compared to 1H 2019. Furthermore, they expected an increase in capital expenditure in 2H 2019, suggesting that business may be starting to have a clearer approach about the business strategy and intend to invest for long-term.

A more optimistic scenario is also expected based on the Business Tendency Statistics report published by the Department of Statistics, Malaysia. The overall business confidence indicator showed that businesses were optimist on their business performance for 3Q 2019. Going forward, about 18.2% (2Q 2019: 14.2%) of the business establishments anticipated a more favourable business outlook in the second half of 2019 across all sectors except for respondents in construction sector.

Based on the above assessment, SME GDP growth is projected to expand at a moderate pace of 5.8% in 2019 (2018: 6.2%) (refer to Chart 2.19). Private consumption which has a significant correlation with SME GDP is expected to continue to support the growth of SMEs during the year. SMEs in the services sector, particularly those in the tourism-related industry is anticipated to benefit from positive growth recorded in tourist arrivals in the first seven months of 2019 and increased tourist receipts in the first half of 2019. Moreover, SMEs are expected to gain potential spillovers from the higher targets set in 2019 for tourist arrivals and tourist receipts at 28.1 million and RM92.2 billion respectively. In addition, SMEs in domestic-oriented manufacturing sector, which are mainly in the consumption and construction-related industries will continue to provide further impetus to SME growth.

BOX ARTICLE

Survey on SMEs in 2018

Since 2009, SME Corp. Malaysia has been conducting surveys on SMEs to gauge their performance as well as to identify issues and challenges faced. The feedback gathered through these surveys serves as useful reference for policy formulation and development of capacity building programmes for SMEs. The surveys are conducted by SME Corp. Malaysia through its State offices with support from Bank Negara Malaysia, as well as various industry associations and chambers of commerce.

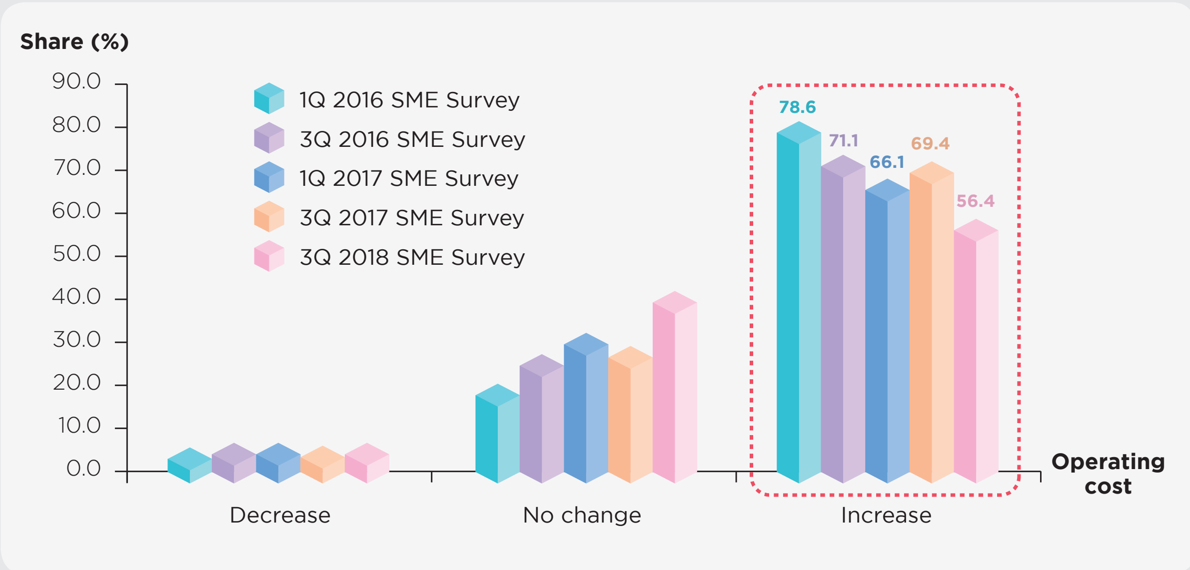
Third Quarter 2018 SME Survey

The Third Quarter 2018 (3Q 2018) SME Survey which garnered 1,721 respondents was comprehensive in terms of economic sectors, business size and geographical coverage. A total of 67.6% of the respondents were from services sector, 23.0% from manufacturing sector, 6.4% from construction and the remaining 3.0% from agriculture sector. Focus of the Survey was on the recent performance of SMEs and their current concerns, such as cost of doing business, taxation, supply chain, financing, export market, human capital as well as information and communication technology (ICT) adoption.

Cost of Doing Business

Increasing cost of doing business continued to be a concern among SMEs although the percentage has seen a decreased of 13.0% as compared to the previous survey conducted in the third quarter of 2017. Based on the findings of the 3Q 2018 SME Survey, a total of 56.4% respondents cited that they experienced an increase in operating cost, particularly SMEs in manufacturing, construction and agriculture sectors as well as the small and medium-sized firms (refer to Chart 1). The cost hike was mainly due to higher cost of raw material and other inputs (67.8%), higher electricity bills and charges (41.0%) as well as rental of business premises (25.3%).

Chart 1: Operating Cost of SMEs (%)



Source: Quarterly SME Surveys, SME Corp. Malaysia

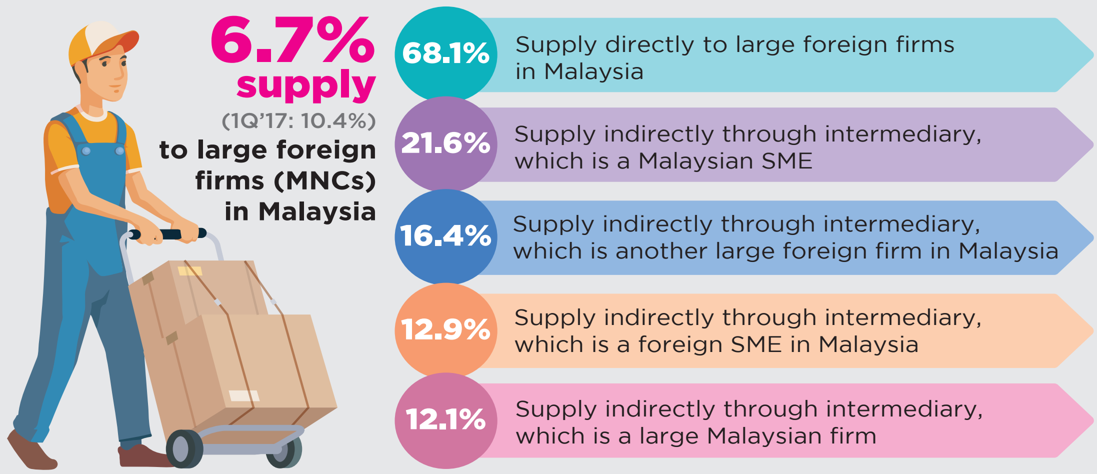
Tax System: Goods and Services Tax (GST) vs Sales and Services Tax (SST)

With the reintroduction of the Sales and Services Tax (SST) on 1 September 2018, SMEs were enquired on their views on the tax systems implemented by the Government. About 59.8% of the SMEs stated that they have registered for Goods and Services Tax (GST). Most of the registered respondents were from manufacturing and construction sectors as well as small and medium-sized firms. Out of that, more than one-third (39.3%) SMEs indicated that they faced issues in claiming for GST refund. Among the issues faced were delayed in GST refund payment, complicated and cumbersome procedure as well as too many documentations needed. More than half of the respondents (56.9%) preferred the SST compared to GST as there are less taxable items under SST and it is perceived as a much simpler tax system than GST. However, SMEs are concern that the reintroduction of SST will give impact on their costs and cash flows. Nevertheless, SMEs felt that it is too soon to tell about the issues faced by them in implementing the SST as it has just been launched and they are also unclear on the mechanism of the SST.

Supply Chain and Business Linkages

Findings of the Survey showed that the supply of SME products and services to large firms was relatively low, with only 6.7% of total respondents supplied to large foreign firms in Malaysia. Of this, majority SMEs (68.1%) supplied directly to large foreign firms in Malaysia, a total of 21.6% supplied indirectly through intermediaries which were Malaysian SMEs, 16.4% supplied indirectly through intermediaries which were other large foreign firms in Malaysia, 12.9% supplied indirectly through intermediaries which were foreign SMEs in Malaysia and another 12.1% supplied indirectly through intermediaries which were large Malaysian firms (refer to Chart 2). The Survey finding which shows low supply of SME products and services to large firms is in line with the study on 'SME Input-Output Table: Analysis and Impact' (please refer next Box Article), which indicated that there is a weak linkage between SMEs and large firms in terms of supply and production. Based on the Study, micro, small and medium-sized firms bought 5.1%, 10.5% and 21.5%, respectively of inputs from large firms for their production process. Whereas, large firms bought much lesser input from microenterprises (0.9%), small (3.9%) and medium-sized firms (5.4%) as large firms are highly dependent on suppliers within their own cluster of large firms as well as imported input. Thus, there is still a big potential for SMEs to supply to large firms.

Chart 2: Linkage between SMEs and Large Firms (%)



Source: 3Q 2018 and 1Q 2017 SME Surveys, SME Corp. Malaysia

Export Market

Based on the Survey, only 13.3% (3Q 2017: 14.7%) of the respondents cited that they have penetrated into international market with an average of 20.0% of their total products or services were sold abroad. Thus, more measures are needed to intensify exports by SMEs. SME exports activity were mainly concentrated in ASEAN and China with a total of 20.5% of respondents were first-time exporters. In order to further boost their export, SMEs undertook various initiatives, such as diversifying into new export markets, building networking with people in the targeted export market, introducing new products and services as well as customising products or services to meet the targeted market standards and regulations. Moving ahead, 17.7% of SMEs that have yet to penetrate into the international market, plan to do so. Among the main concerns of SMEs in exporting products or services are inadequate information on the targeted market, inadequate knowledge on competitors and expects to incur higher operating cost.

Chart 3: Constraints for SMEs to Export (%)

53.3% Inadequate information on the targeted market (3Q 2017: 43.9%)

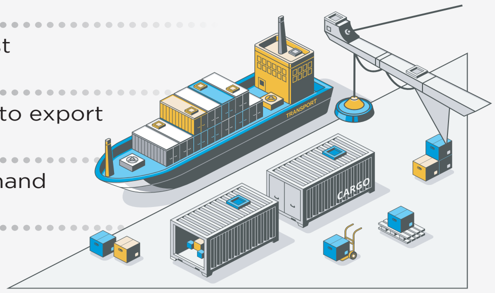
46.0% Inadequate knowledge on competitors (3Q 2017: 30.2%)

43.4% Expects to incur higher operating cost (3Q 2017: 38.6%)

42.9% Insufficient knowledge on procedure to export (3Q 2017: 33.3%)

40.7% Inadequate knowledge on global demand (3Q 2017: 37.0%)

40.4% Inadequate source of financing (3Q 2017: 30.0%)

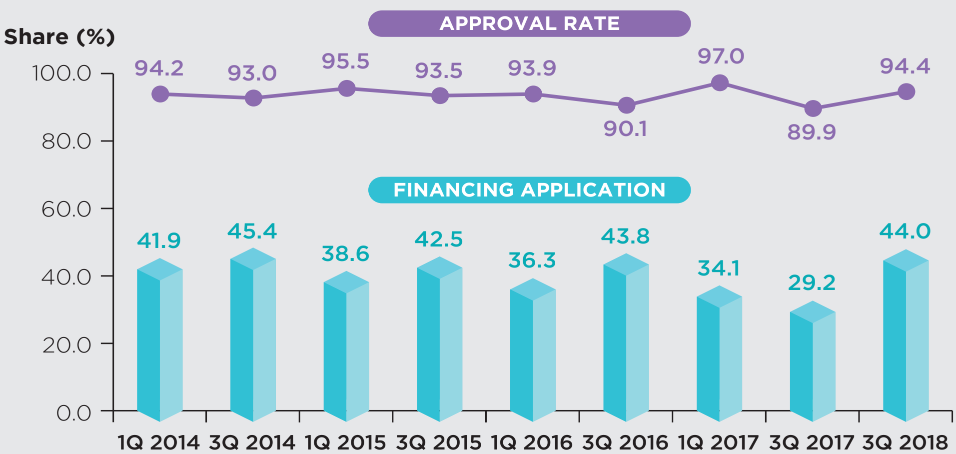


Source: 3Q 2018 and 3Q 2017 SME Surveys, SME Corp. Malaysia

Business Financing

SMEs continued to have access to financing from financial institutions with a high approval rate of 94.4%, higher than the approval rate for the same quarter in 2017 (89.8%) (refer to Chart 4). Of those approved, about 25.0% were made up of first-time borrowers. The demand for loan from financial institutions also increased from only 29.2% in the third quarter of 2017 to 44.0% in the third quarter 2018. The main purpose of financing were for additional working capital, business expansion and to purchase machinery and equipment. Meanwhile, about 5.6% of the total financing applications were rejected mainly due to insufficient sales, income or cash flows by SMEs.

Chart 4: Financing Application and Approval Rate (%)



Source: Quarterly SME Surveys, SME Corp. Malaysia

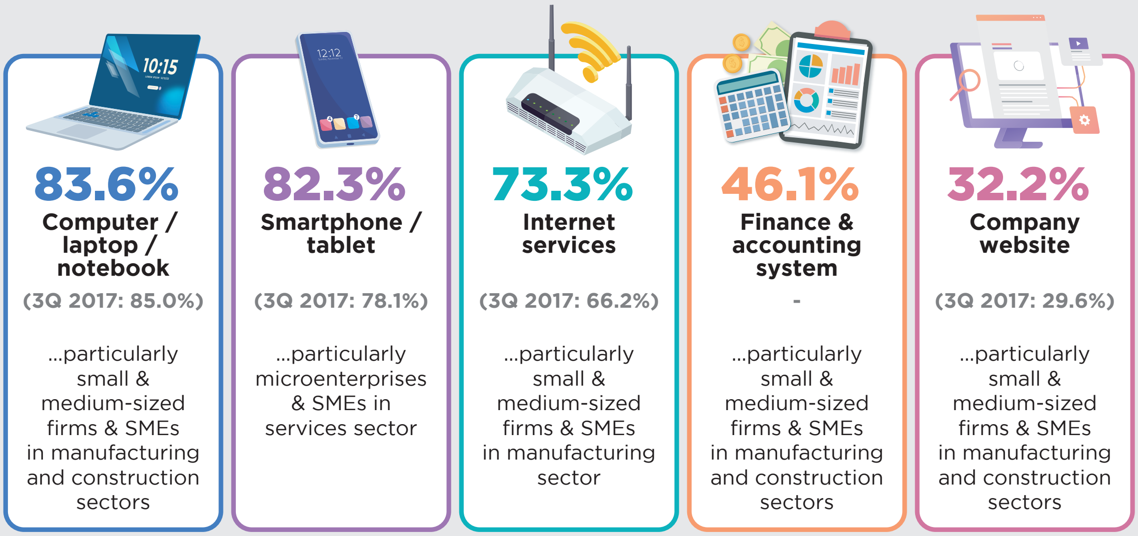
Human Capital

The Survey showed that a total of 17.3% of SMEs hired foreign workers which is relatively low. However, SMEs are dependent on them as 39.9% indicated that they had no intention to reduce dependency on foreign workers. SMEs were also enquired on their awareness on internship programmes involving students from the Technical and Vocational Education and Training (TVET), of which a total of 33.7% of SMEs responded that they were aware. From those who were aware, 41.4% cited that they have engaged the TVET students for practical training and 92.1% of those engaging the TVET students have benefitted from the internship programme. However, SMEs also responded that graduates produced by TVET institutions often do not meet the industry demand due to lack of technical skills, unable to work independently and attitude problem.

ICT Adoption

Generally, the utilisation of information and communication technology (ICT) among SMEs has been on an increasing trend (refer to Chart 5). This is evident from the findings of the Survey, whereby majority of the respondents utilised computer (83.6%), smartphones or tablets (82.3%) and internet services (73.7%) in their daily business operation. The Survey revealed that a total of 37.9% of SMEs involved in online business, higher than 28.0% recorded during the 3Q Survey 2017 SME Survey, with average online sales stood at 30.0% to total business sales. In terms of type of online platform used, Facebook dominated the chart at 87.7%, followed by WhatsApp (73.5%), and Instagram (64.9%). However, majority of the online business were for domestic market. Nevertheless, majority of SMEs that have not embarked on online business indicated that the online business is not necessary for their business and they prefer traditional way of doing business.

Chart 5: ICT Adoption among SMEs (%)



Source: 3Q 2018 and 3Q 2017 SME Survey, SME Corp. Malaysia

BOX
ARTICLE

Manufacturing Sector: From the Lens of Input-Output Table

The transition of Malaysia from agricultural-based economy to one with greater focus on industrialisation has witnessed a rapid growth in the manufacturing sector over the years. In 2018, manufacturing sector remained to be the principal driver of growth after services sector, as it expanded by 5.0% (2017: 6.0%) and accounted for 22.4% of Malaysia's real gross domestic product (GDP). Meanwhile, within the SME landscape, SMEs in the manufacturing sector outperformed the overall manufacturing sector in recent years, with average annual growth rate of SMEs at 5.7% compared to 5.1% for the overall manufacturing in the growth period of 2016 - 2018.

While Malaysia is steadily progressing towards a more diversified service-based economy, the manufacturing sector continues to play an important role in the economic development of the country. The transformation of the economy will be more focused on creating higher value-added activities, of which active participation in the supply chain by businesses and SMEs will greatly help to spur sustainable economic growth across the board. SME Corp. Malaysia's study on Input-Output Table for SMEs provides a better perspective on the issues and challenges in the existing supply chain.

A broad framework in assessing the interdependence of various industries or sectors in acquiring and purchasing inputs is being laid out through SME Input-Output (SME-IO) Table. The publication on SME-IO Table: Analysis and Impact describes in detailed the inter-industry interactions, of which industries use products or services of other industries to produce their own products or deliver their own services. This section will hence feature the analysis on manufacturing sector in terms of value-added, business linkages and its potential to drive the economy.

Perspective from the Input-Output Table

Based on Malaysia Input-Output Tables 2010 published by Department of Statistics, Malaysia, the manufacturing sector contributed the largest in terms of total output, producing about RM896.2 billion or 43.2% of total output in the economy (refer to Table 1). From RM896.2 billion of total output produced by the sector, about RM307.0 billion was consumed by all five economic sectors including manufacturing sector through intermediate demand, while another RM589.2 billion was consumed by final demand components.

In order to produce the manufacturing output, the sector needs a total of RM896.2 billion of input, whereby RM433.1 billion was supplied by all five economic sectors, RM278.1 billion from imports, RM5.0 billion of taxes paid to the Government, RM182.9 billion of value-added created and subtracting RM3.0 billion of subsidies received from the Government.

Table 1: Simplified Structure of Malaysia Input-Output Tables 2010 (RM billion)

Malaysia Input-Output Table 2010 (RM billion)	INTERMEDIATE DEMAND						FINAL DEMAND					
	Agriculture	Mining & Quarrying	Manufacturing	Construction	Services	TOTAL INTERMEDIATE DEMAND	Private Consumption	Government Consumption	Gross Fixed Capital Formation	Change in Invertory	Exports	TOTAL OUTPUT
Agriculture	7.8	-	73.9	0.0	6.1	**87.8**	19.6	-	3.4	0.4	12.6	**123.9**
Mining & Quarrying	0.0	0.9	60.2	2.2	0.8	**64.3**	0.1	-	-	(0.4)	43.2	**1.7.2**
Manufacturing	14.1	5.3	180.6	28.5	78.6	**307.0**	84.3	-	20.3	7.7	477.0	**896.2**
Construction	0.8	0.8	3.7	6.5	8.2	**20.0**	6.8	-	58.7	-	5.3	**90.8**
Services	14.4	5.0	114.7	10.0	239.1	**383.2**	245.7	101.4	17.2	2.2	106.5	**856.1**
TOTAL INTERMEDIATE INPUT	**37.0**	**12.1**	**433.1**	**47.2**	**332.8**	**862.2**	**356.6**	**101.4**	**99.6**	**9.9**	**644.5**	**2,074.2**
Direct Purchases Abroad by Residents	-	-	-	-	-	**-**	26.7	-	-	-	-	**26.7**
Domestic Purchases by Non-residents	-	-	-	-	-	**-**	(58.4)	-	-	-	58.4	**-**
Imported Commodities	11.2	6.3	278.1	15.8	91.6	**403.1**	56.1	5.2	78.1	4.0	35.7	**582.0**
Taxes on Products	0.9	0.2	5.0	0.4	6.2	**12.8**	9.4	0.0	4.9	-	5.5	**32.6**
Subsidies on Products	1.0	0.4	3.0	0.4	4.3	**9.1**	3.3	-	-	-	-	**12.4**
Value-added	75.7	88.9	182.9	27.8	429.7	**805.2**	387.1	106.5	182.6	13.8	744.0	**2,703.2**
TOTAL INPUT	**123.9**	**107.2**	**896.2**	**90.8**	**856.1**	**2,074.2**						

Note: Figures may not necessarily add up due to rounding
Source: Malaysia Input-Output Tables 2010, Department of Statistics, Malaysia

In addition, manufacturing sector is a major consumer of intermediate input in several economic sectors. As high as 93.6% and 84.2% of total intermediate demand from mining & quarrying and agriculture sectors respectively were consumed by the manufacturing sector, thus emphasising the heavy reliance on the manufacturing sector in terms of intermediate demand (refer to Table 2).

Table 2: Intermediate Input Demanded by Manufacturing Sector

Sectors	Demand by Manufacturing Sector (RM bil)	Total Intermediate Demand (RM bil)	Share of Demand by Manufacturing Sector to Total Intermediate Demand (%)
Agriculture	73.9	87.8	84.2
Mining & Quarrying	60.2	64.3	93.6
Manufacturing	180.6	307.0	58.8
Construction	3.7	20.0	18.5
Services	114.7	383.2	29.9

Source: Malaysia Input-Output Tables 2010, Department of Statistics, Malaysia

Looking from the SMEs perspective, findings of the SME-IO Table: Analysis and Impact showed that SMEs contributed about one-third (32.3%) to total value-added created in the economy and 31.9% to total output (refer to Table 3). Focusing on the manufacturing sector, SMEs in the sector is the second biggest contributor to the SME value-added (17.0%) and SME output (37.9%). In terms of imports, it can be seen clearly that the SMEs in manufacturing sector is the main driver of the SMEs ecosystem, contributing 54.6% of SMEs' total imports.

Table 3: Contribution to Value-added, Output and Imports by Economic Sectors

Sectors	Value-added (nominal terms)			Output			Imports		
	RM billion	% to total	% to SMEs	RM billion	% to total	% to SMEs	RM billion	% to total	% to SMEs
SMEs	**260.1**	**32.3**	**100.0**	**662.5**	**31.9**	**100.0**	**102.1**	**25.3**	**100.0**
Agriculture	33.1	4.1	12.7	55.3	2.7	8.3	5.4	1.3	5.3
Mining & Quarrying	3.7	0.5	1.4	5.4	0.3	0.8	0.5	0.1	0.4
Manufacturing	44.2	5.5	17.0	251.0	12.1	37.9	55.8	13.8	54.6
Construction	6.3	0.8	2.4	19.8	1.0	3.0	3.7	0.9	3.7
Services	172.7	21.5	66.4	331.1	16.0	50.0	36.7	9.1	36.0
Large Firms	**358.2**	**44.5**	-	**995.3**	**48.0**	-	**253.0**	**62.8**	-
Rest of Sectors (RoS)	**186.8**	**23.2**	-	**416.4**	**20.1**	-	**48.0**	**11.9**	-
Total	**805.2**	**100.0**	-	**2,074.2**	**100.0**	-	**403.1**	**100.0**	-

Note: Figures may not necessarily add up due to rounding
Source: SME Input-Output Table, SME Corp. Malaysia

Information on the output consumption by industries and final consumers can be further analysed by exploring the output structure across all economic sectors. Generally, output is consumed by consumers and investors locally (domestic market) or exports (foreign market). Intermediate demand, private consumption, Government consumption and investment are the four components that describes domestic demand, while exports are considered as foreign demand.

From the total output of RM251.0 billion produced by SMEs in the manufacturing sector, RM112.3 billion (44.7%) flowed back into the economy as intermediate input (refer to Table 4). Exports contributed as high as RM106.4 billion (42.4%) of manufacturing SMEs' total output while the balance of RM32.3 billion (12.9%) went to the domestic demand component. The findings highlighted that the output produced by SMEs in the manufacturing sector was the most highly demanded by foreign parties, while other economic sectors were more domestically integrated. The difference in export intensity across economic sectors and the market it serves suggest that different policies are required to drive the growth of these sectors.

Table 4: Output Production of SMEs by Economic Sectors

Sectors	Intermediate Demand		Private Consumption		Government Consumption		Investment		Exports		Total Output	
	RM billion	% to total output	RM billion	% to total output	RM billion	% to total output	RM billion	% to total output	RM billion	% to total output	RM billion	% to total output
SMEs	**321.6**	**48.5**	**129.5**	**19.6**	**4.6**	**0.7**	**31.7**	**4.8**	**175.1**	**26.4**	**662.5**	**100.0**
Agriculture	33.4	60.4	13.7	24.9	-	-	2.3	4.1	5.8	10.6	55.3	100.0
Mining & Quarrying	4.7	87.1	0.0	0.0	-	-	-0.003	0.0	0.7	12.9	5.4	100.0
Manufacturing	112.3	44.7	23.7	9.4	-	-	8.6	3.4	106.4	42.4	251.0	100.0
Construction	5.3	26.8	2.5	12.9	-	-	11.0	55.6	1.0	4.8	19.8	100.0
Services	165.9	50.1	89.6	27.1	4.6	1.4	9.9	3.0	61.2	18.5	331.1	100.0

Note: Figures may not necessarily add up due to rounding
Source: SME Input-Output Table, SME Corp. Malaysia

Reliance on Imports by Manufacturers

As highlighted earlier, SMEs in the manufacturing sector have high import intensity compared to other economic sectors as they imported most of their inputs. Analysis from the SME-IO Table showed that most industries with high import multipliers tend to have low value-added multipliers. Higher dependency on imports will significantly drag the value-added creation since imports are considered as the leakage source in the economy. Among SMEs, the top ten industries with high imports multiplier were all in manufacturing sector i.e. insulated wires & cables; optical instruments & photographic equipment; and basic precious & non-ferrous metals (refer to Table 5). Moreover, looking at the composition of input requirement of these industries, it can be seen that they imported more than half of its total inputs whereby optical instruments & photographic equipment industry topped the list at 65.4%.

Table 5: Top 10 Industries among SMEs with High Import Intensity

Industry	Import Multiplier	Value-added Multiplier	Share of Import Content to Total Input (%)
Insulated wires & cables	0.762	0.236	64.3
Optical instruments & photographic equipment	0.726	0.272	65.4
Basic precious & non-ferrous metals	0.683	0.313	56.8
Electrical machinery & apparatus	0.618	0.376	46.7
Domestic appliances & office, accounting & computing machinery	0.612	0.386	56.7
Instruments & appliances for measuring, checking, testing, navigating and other purpose; manufacture of industrial process control equipment	0.606	0.385	51.4
Casting of metals	0.604	0.392	47.4
Motor vehicles	0.587	0.352	46.1
Semi-conductor devices, electronic valves, tubes & printed circuit boards	0.586	0.412	56.6
Iron & steel products	0.566	0.431	34.4

Source: SME Input-Output Table, SME Corp. Malaysia

Take note that most of these industries are non-resource based and most of the raw materials being used for production are not available locally but can only be obtained from overseas, such as grade steel, engineering steel and engineering plastics. In fact, SME manufacturers highlighted that their clients specifically quoted for the usage of these high-grade high specification metals or raw materials, thus the issue on outsourcing imported materials cannot be avoided given the nature of their businesses.

While these industries may have high import intensity, no less attention should be given as these industries are complementing the high technology industries, of which they have greater potential and capability to diversify into more complex and high value projects with higher economic returns to the country. Hence, to better cope with the heavy reliance on imported input, more efforts and policy measures are needed to increase the local content and reduce imported input in these industries as higher import dependence may result in lower linkages among the domestic production sector.

Importing raw materials may provide a quick solution for manufacturers currently, but developing capabilities internally among the local firms particularly SMEs is more important. SMEs need to continuously strengthen their capacity and capability to improve their business operations that will eventually allow them to produce high quality products and services. It would also enable them to upscale their business in terms of getting the right skills, hiring more technical expertise and enhance their production capacity in order to compete efficiently. Having local SMEs to produce the right grade and quality of the raw materials for manufacturers may result in better cost savings, boost the supply chain among the local industries and at the same time foster the economy.

“DRIVING SMEs ENTREPRENEURSHIP”

Enhancing Business Linkages in Manufacturing Sector

Going forward, the transformation of the economy towards higher value-added activities will be driven by the existing and new industries migrating up the value chain, of which knowledge, innovation and productivity are central to value creation. As SMEs are the backbone of the economy, they will play a prominent role in transforming Malaysia into a high-income nation. Among the measures to further enhance the business linkages in the manufacturing sector include:

1

Strengthen Vendor Development Programme (VDP) by increasing the participation of new anchors from Government-linked companies (GLCs), multinational companies (MNCs), public-listed companies and vendor champions. This will stimulate the capability of SMEs as suppliers to these big players. In the long run, it is expected that SMEs do not just focus on supplying products in the local market, but also seize the opportunities to penetrate into international market.

2

SMEs in high-growth industries to be further developed, such as in automotive, aerospace, biotechnology, medical devices, renewable energy, rail and halal industries. Emerging technologies like Internet of Things (IoT), megatrend, additive manufacturing, artificial intelligence (AI) and robotics are highly required in these high tech industries, thus the involvement of big players could better assist and nurture SMEs into becoming highly dynamic, innovative and competitive firms.

3

Supplying to Government and large firms is an important step to widen market penetration and enhance business linkages. Nevertheless, SMEs currently have limited access to procurement by Government and large firms following perception that products and services by SMEs are of low quality and they have low capacity volume which limits their bargaining power in the supply chain. Enforcing procurement from SMEs will help to give greater support and boost confidence in locally manufactured products, while at the same time provide cost savings to the Government.

The Government is committed in assisting entrepreneurs and improve the competitiveness of SMEs so that they can actively participate in the global value chain as well as being a part of the Industrial Revolution 4.0 and digitalisation. Focus will be on creating innovative and globally competitive firms that are resilient to challenges arising from liberalisation and digitally-integrated business environment. Policies being outlined for entrepreneurial development in Malaysia will continue to be the catalyst for the national's inclusive economic transformation going forward.

(Input contributed by Federation of Malaysian Manufacturers)