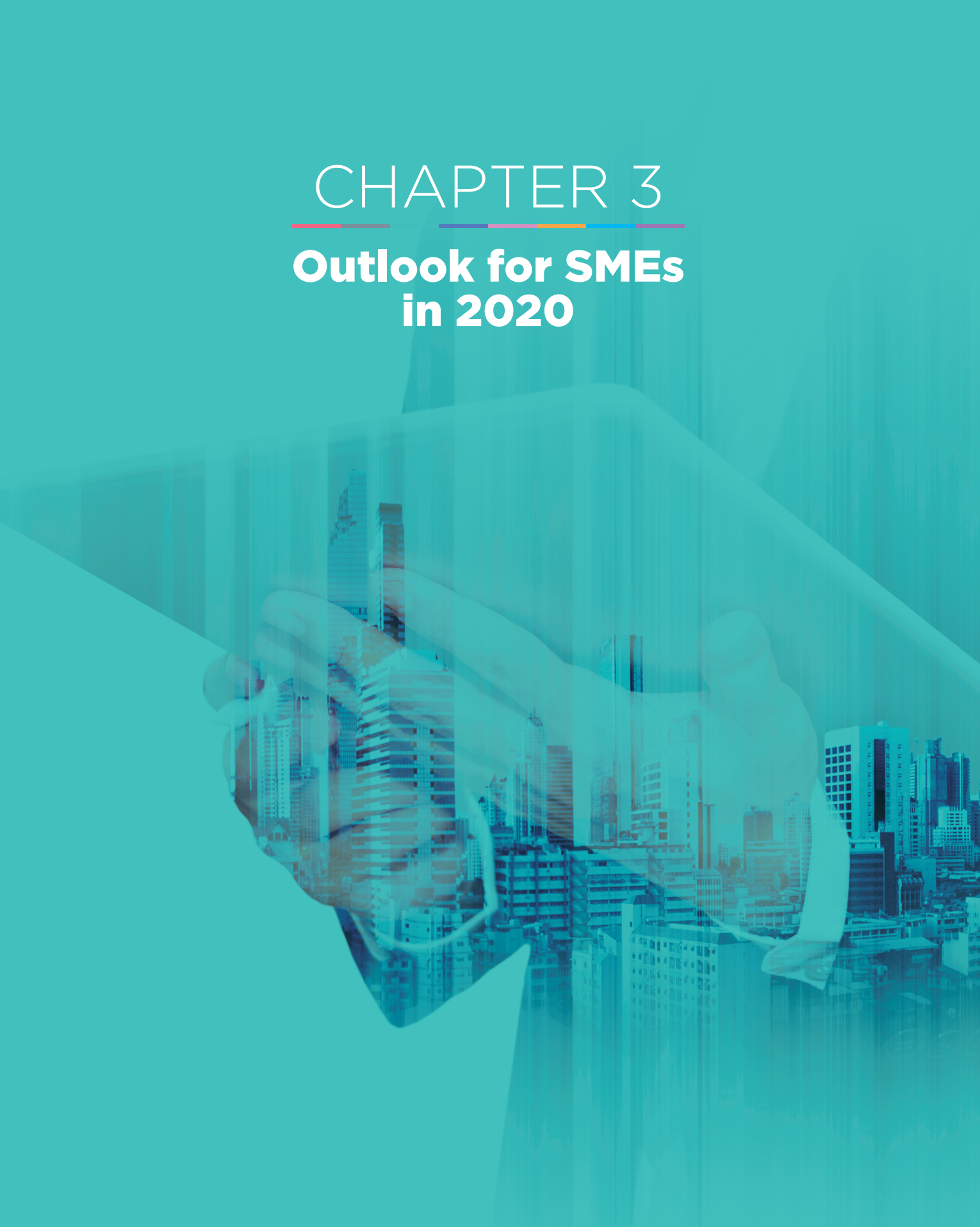


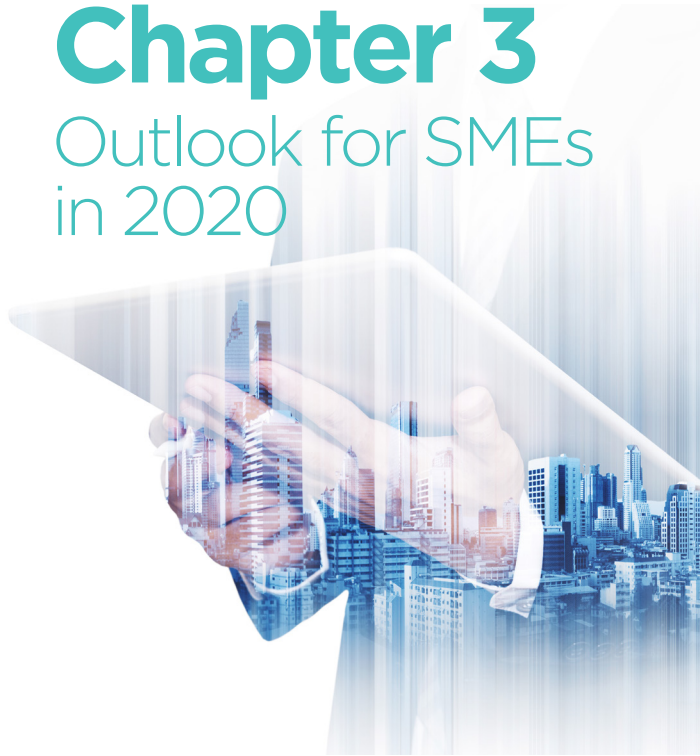
CHAPTER 3

Outlook for SMEs in 2020



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The outbreak of COVID-19 is a significant global health crisis, touching every corner of the world. From rising health issues to economic slowdown, financial imbalance, interrupted social life and political consequences, the pandemic has affected and reshaped countries across the globe.

Global and Malaysian Economy Outlook

Severely disrupting the economy, the COVID-19 significantly weakened the global growth prospects. The International Monetary Fund (IMF) in its World Economic Outlook (WEO) Update January 2021 reported that the global economy registered a negative growth of 3.5% in 2020 (2019: 2.8%). The revised figure was 0.9 percentage point higher than the one estimated previously in the WEO October 2020, reflecting stronger-than-expected momentum in the second half of 2020.

For the case of Malaysia, the year 2020 was expected to be a booming time particularly for the tourism industry with its Visit Malaysia 2020 campaign was set in motion. However, the COVID-19 pandemic which escalated from a health crisis into an economic crisis has hampered the campaign and various initiatives are rendered to promote tourism-related activities until the global outbreak is under control. The spreading of the virus and measures taken to contain it which includes travel restrictions, enforced business closures and restricted social activities following phase-by-phase Movement Control Order (MCO) were causing simultaneous supply and demand shocks to the domestic economy. Businesses, particularly SMEs are struggling to cope with the operational stress brought by COVID-19.

Reflecting the impact of the pandemic, the Malaysian economy further declined to register a negative growth of 3.4% in the fourth quarter of 2020, which was the third consecutive contraction for the year (3Q 2020: -2.6%, 2Q 2020: -17.1%). Negative growth was recorded in all economic sectors except manufacturing. The contraction during the quarter was largely attributable to the imposition of the Conditional MCO on a number of states since mid-October. The economic prospect and recovery momentum was affected by the recent resurgence of COVID-19 cases and targeted containment measures in several states in the last quarter of 2020. While mobility restrictions namely the inter-district and inter-state travel ban has weighed on economic activity, growth remained supported by the continued improvement in external demand. Taking into account the full-year economic performance in 2020, the economic activity in Malaysia contracted by 5.6%, its biggest decline since financial crisis.

Chart 3.1: Annual GDP Growth for 2020



Sources: IMF World Economic Outlook Update, January 2021 and BNM Quarterly Bulletin 4Q 2020, February 2021

Business Outlook from the View of Business Associations and Economic Indicators

Dealing with the unforeseen challenges caused by the COVID-19 pandemic has taken a significant toll on businesses. Based on the 4Q 2020 Vistage-MIER CEO Confidence Index (CCI) which surveyed mainly CEOs of small to mid-sized businesses, expectations of the economy are gloomy in the near-term, with 55% believed that the economy will take a turn for the worse in the coming months. The CCI remained below the optimism threshold for nine

consecutive quarters, reflecting a continuing lack of confidence amongst CEOs. Also, according to Survey on Entrepreneurs for Post COVID-19 conducted by the Ministry of Entrepreneur Development and Cooperatives (MEDAC) from 15 to 31 July 2020, more than half of entrepreneurs and SMEs (54.2%) expect negative business revenue in 2020 compared to the previous financial year.

Substantial economic disruption on demand and supply in the domestic and global economy due to the pandemic has affected firms' near-term economic outlook. Findings from the Malaysia's Business and Economic Conditions Survey Report published by the Associated Chinese Chambers of Commerce and Industry Malaysia (ACCCIM) showed that respondents are expecting bearish outlook for both business (64.3%) and economic conditions (68.9%) in the second half of 2020. Despite that most business activities have resumed operations under the Recovery MCO in the second half of 2020, they are still facing a slow pace of recovery in consumer demand and operating cost remains a challenge.

Looking at the retail segment, the industry too has taken one of the biggest hits due to the pandemic, thus posing risk to SMEs realising that a total of 45.6% of SMEs are in the wholesale and retail trade industry. In the November 2020 Malaysia Retail Industry Report, Retail Group Malaysia (RGM) has

further revised downward its projection for the annual retail growth rate, to decline by 15.8% in 2020 as compared to the previous forecast of -9.3% (estimated in September 2020). The third-wave of COVID-19 pandemic and the extension of the MCO until year-end had weakened the spirit of Malaysian retailers, thus highlights the year 2020 has been the worst period for the retail industry since 1987. Most retailers were not able to operate at full capacity due to the continuous social distancing measures and strict standard operating procedures (SOPs) being enforced. Moreover, a sharp negative growth of 18.2% in the fourth quarter of this year is projected, far worse off than the earlier estimate of -2.5%. Even almost all retail sectors are allowed to operate, consumers are still cautious in spending given the resurgence of new cases and concerns on the spread of the virus.



Meanwhile, there is a less promising performance among manufacturers in Malaysia as they were struggling against the COVID-19 headwinds. The IHS Markit Malaysia Manufacturing Purchasing Managers' Index (PMI) in November 2020 fractionally dipped to 48.4 (October 2020: 48.5), remained below the normal level of 50 for the fourth time in a row since August 2020. Losing the recovery momentum seen during the initial rebound post-economic reopening, the renewed restrictions following the resurgence in new COVID-19 cases have dampened the domestic activity. At the same time, lockdowns in other countries too have contributed to weakness in exports and caused further delays in the supply of materials. Both production and new order volumes had slowed down, though the pace of deterioration was markedly softer than in April 2020. Nonetheless, looking at the 12-month outlook, manufacturers have high hopes that an end to the pandemic would increase demand and boost production.

Losing the recovery momentum seen during the initial rebound post-economic reopening, the renewed restrictions following the resurgence in new COVID-19 cases have dampened the domestic activity. At the same time, lockdowns in other countries too have contributed to weakness in exports and caused further delays in the supply of materials.

In line with the less favourable outlook found in many studies done by business chambers, Survey on SMEs Sustainability and Survival during MCO conducted during the period of 27 to 30 April 2020 by SME Association of Malaysia shows that SMEs are looking at various strategies to survive and sustain as businesses restarting their operations in stages after the MCO period. Uncertainties brought about by the COVID-19 pandemic have flustered the confidence of SMEs on the economy and their business prospects. A total of 28.8% of SME respondents are expecting to restructure their businesses while 23.4% will downsize their operations to cope with the challenging times.

Nevertheless, several economic indicators offered a breath of fresh air. Looking at the Leading Index published by the Department of Statistics, Malaysia (DOSM) which monitors the future economic direction in an average of four to six months ahead, the index recorded an annual positive growth of 8.6% in

September 2020, expanding at a much faster pace than the growth recorded in August (7.6%) and sharpest decline of 5.7% recorded in April 2020. Continue to record positive growth since May 2020, the improvement is in line with the restart of the economic activity and resume of most business operations. Despite challenging circumstances, the growth rate of the index maintained above trend which signifies that Malaysia continues to chart economic recovery. Series of stimulus packages and implementation of short-term economic recovery plan, coupled with various assistance in the Budget 2021 announcement will also help to cushion the COVID-19 impact, ensure business continuity and boost economic resilience.

While that provides positive sign on the economic health, businesses still need to be cautious given the continuing uncertainties and challenges in the domestic and global environment. The severe economic fallout from the COVID-19 pandemic has not only weighed heavily on the business sentiment and brought ample challenges to SMEs, but it has also enlightened the importance of having sustainable business model in the long run. Adapting to the new norm, SMEs should relook at their business model in order to stay flexible, responsive and innovative in making the best of this pandemic. The ability to effectively adjust the mode of business operations to suit the current difficult situation can help maintain competitiveness, improve business reliance and thus be a success factor amidst a changing landscape.



Projection for SME GDP in 2020

SMEs in Malaysia are the backbone of the economy, representing a majority 98.5% of the overall business establishments in 2015. With the large number of SME establishments in the country, any economic downturn will inevitably affect various sectors and national economic progress. The COVID-19 pandemic has certainly impacted the economic well-being of people and businesses. As highlighted in the previous segment, many business associations stressed on the downbeat outlook in the near-term. While the pandemic continues to have a profound impact on SMEs, SMEs remain being resilient in the face of the adversity by proactively taking steps to protect their businesses. SME Bank in July 2020 forecasted the growth of SMEs to decline by 1.0% in 2020. The less severe negative growth forecast is supported by the expected increase in household income, which signifies the increasing purchasing power of consumers and on the expectation that SMEs to remain competitive in the post-MCO period by leveraging on technology.

Taking into account the performance of SMEs in past years, they consistently outperformed the overall economic growth, thus demonstrating their business resilience be it during crisis or economic stability. In 2020, while the overall economy in Malaysia shrank by 5.6%, the SMEs are projected to decline by 5.4%. This projection has taken into account the third wave of the COVID-19 infections that took place in the second half of 2020. The global and domestic economic uncertainties will continue to cloud both consumer and business sentiments, leading to slowing business activities going forward. Nevertheless, the series of economic stimulus packages announced by the Government will further provide ample support to SMEs in easing their financial burden and at the same time withstand the impact from the COVID-19 outbreak.

Moreover, in minimising the impact of the pandemic to the SME businesses while help to accelerate the recovery process, SMEs should make use of technology, given that it serves as a business enabler that paves the way for greater productivity, operational efficiency and cost-savings.

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Projection for SME Exports in 2020

As the COVID-19 pandemic disrupts global trade flows and hampers supply chains, the year 2020 has been challenging to global trade. Most countries around the world are still in lockdown and tightening measures are still ongoing to reduce the transmission of COVID-19, thus disruptions to manufacturing activities and movement of goods globally remained. The temporary shut downs nationwide following the implementation of MCO has disrupted domestic production and delayed investment. Looking at the full-year performance, Malaysia's exports in 2020 declined marginally by 1.4% (2019: -0.8%) to reach RM980.99 billion, in tandem with softer global demand and unfavourable external economic conditions following the COVID-19 pandemic.

Nevertheless, comparing the half-year performance, Malaysia's external trade performed fairly well in the second half of the year with exports expanded by 4.8%, a significant improvement from the negative growth of 7.9% recorded in the first half of 2020. The better exports performance in the second half of the year was attributed to the progressive opening of the

economy and gradual recovery of external demand. Also, exports marked its positive momentum in December 2020, recorded the highest monthly export value for the year, contributed by higher exports in electrical and electronics products, rubber products and palm oil & palm oil-based agriculture products. .

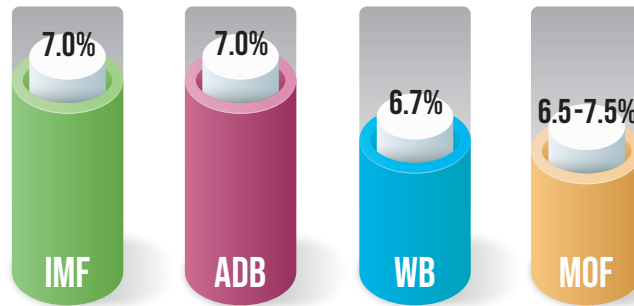
Zooming in to the small businesses, quite a significant portion of SMEs rely on international trade for their activities, either for export or import. In 2019, contribution of SMEs to the country's total exports increased to 17.9% with growth supported by continued expansion in the services sector particularly in tourism-related industries and other business services. While these SMEs are integrated into the global value chains, supply chain disruptions such as those brought by the pandemic has posed risk to export-oriented SMEs. Thus, they are expected to take a hit from the discouraging exports performance, though to a smaller extent as compared to the large firms. Against the backdrop of a challenging global environment, SME exports is projected to contract by 2.8% in 2020 (2019: 2.6%).

As one of the key contributors to exports, the tourism activity which has been badly affected is poised to drag the exports growth performance of SMEs during the year. Take note that there were altogether 504,554 SMEs involved in the tourism industry in 2015, of which covers 55.6% of the total SME population. On top of that, more than one-third of SME exports were generated by the travel services sub-sector.

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Outlook for SMEs in 2021

As the global economy was in recession in 2020 and negatively affected following the after effect of COVID-19 outbreak, the year 2021 however will offer a more upbeat prospect. The IMF projected for the global economy to gradually recover in 2021, to expand at a positive growth of 5.5%. While renewed waves and new variants of the virus pose concerns to the outlook, the higher growth projection of the global economy reflects the additional policy support in a few large economies and expectations of a vaccine rollout in facilitating the resumption of economic activity. In line with the projected improvement in global growth, the Malaysia's growth prospect too is subsequently expected to bounce back in 2021 as outlined by various international agencies (refer to Chart 3.2). Moreover, during the Budget 2021 announcement in November 2020, Ministry of Finance has officially projected for the economy to expand within the range of 6.5 - 7.5% in 2021. Nevertheless, the projected recovery is subject to the effective curbing of the pandemic, provision of vaccines globally and domestically and sustained recovery in external demand.

Chart 3.2: Malaysia's Growth Projection for 2021

Sources: IMF World Economic Outlook Update, January 2021
 Asian Development Outlook 2020 Supplement, December 2020
 World Bank Global Economic Prospects, January 2021
 MOF Budget 2021 Announcement, November 2020

In preserving the vitality of economy, series of economic stimulus measures will help to provide sizeable assistance to households and businesses. Government measures such as *Pakej Rangsangan Ekonomi Prihatin Rakyat* (PRIHATIN), KITA PRIHATIN, *Pelan Jana Semula Ekonomi Negara* (PENJANA) and *Pakej Bantuan Perlindungan Ekonomi dan Rakyat Malaysia* (PERMAI) as well as initiatives under Budget 2021, specifically the Bantuan Prihatin Rakyat, targeted wage subsidies and public projects will further improve the economic landscape and giving boost to small businesses. Additionally, the continued financial measures and low interest rate environment are also expected to lend further support to economic recovery. Hence, the impact of these initiatives is anticipated to have spillover effects and provide an additional boost to the economy in 2021, coupled with the anticipated improvement in global growth and international trade.

According to Survey on Entrepreneurs for Post COVID-19 by MEDAC, a total of 29.5% of entrepreneurs and SMEs anticipate the Malaysia economy to fully recover by the first quarter of 2021. In line with that finding, the Survey by ACCCIM stating that a total of 46.4% of respondents expect the Malaysian economy to recover in the first half of 2021. Pessimism sentiment remains in 2021 but to a much lower extent, signifying that firms cautiously expect a better business prospect. For the year 2021, findings indicate that lesser number of respondents (23.1%) having pessimistic views on business conditions (2020: 67.7%), while more respondents (13.1%) are optimist (2020: 3.8%).

With the IMF projecting a solid 7.0% year-on-year growth for Malaysia in 2021, SMEs must make themselves ready to take advantage of the recovery as the world recovers from the COVID-19 pandemic. Based on the rebound expectation in 2021 outlined by the Ministry of Finance, Bank Negara Malaysia, business associations and research agencies, SME businesses are projected to recover and improve markedly in 2021. In navigating the business to the new norm and thriving in post-pandemic reality, SMEs should make further business enhancement which may include embedding new digital technologies in their business model to raise productivity and efficiency; improving human resource skills and capabilities; and strengthening their cash flow position. The unprecedented outbreak of COVID-19 too has highlighted the importance of putting in place effective contingency plans to ensure business continuity for any given catastrophe or shocks that may occur in the future.