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**PERCEPTIONS OF BUSINESS CHALLENGES: THE MALAYSIAN SMEs
EXPERIENCE**

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Abstract

In this paper, we conduct a survey of the major challenges that hinder business growth of small and medium sized enterprises (SMEs) in Malaysia. While similar studies can be found in the literature, this study is unique and significant in a number of ways. Here, we have classified business challenges into six major factors, namely, inaccessibility to finance, lack of skilled human capital, business competition, inaccessibility to technology and innovation infrastructure, non-conducive government policies and weak business incentives. The findings show that (1) inaccessibility to technology and innovation infrastructure, (2) non-conducive government policies and (3) lack of skilled human capital pose the most significant challenges to SMEs in undertaking their business activities productively. Further, we find that there is a significant correlation between these three challenging factors with some of the SME profiles (i.e. the type of business, export orientation and sales turnover volume). This study also suggests several policies on how to overcome or minimize the identified business challenges for SMEs in Malaysia.

JEL classification: M10, M13

Keywords: SME, Malaysia, business competition, innovation, human capital, government policies

1. Introduction

The ever-changing business environment requires firms to adapt quickly to new challenges and competition. This is even more so for small businesses. Today, small businesses face competition from not only their peers, but also from larger corporations. More and more multinational corporations are participating in niche markets which were once the preserve of smaller businesses. In fact, reliance on domestic markets for business growth is a thing of the past for SMEs in most economies. Consequently, SMEs need to identify, prioritize and tackle effectively such business challenges in order to be more competitive and relevant in the business world. This scenario is also applicable to SMEs in Malaysia. The development of the SME sector in Malaysia has been phenomenal, having contributed significantly to economic growth over a number of years (BNM, 2005). In spite of this little effort has been made in identifying the impending challenges that SMEs face in the conduct of their business. Recognition and identification of such challenges may assist both the government and industry players in taking the necessary actions to mitigate these problems, and facilitate further strong growth of the SME sector.

The objectives of this study are twofold. First, a survey is conducted to identify some of the major challenges that SMEs in Malaysia perceive as hindering their growth. To this end the SME survey sample were asked to identify the most critical challenges which they faced out of six major pre-determined challenges presented to them (i.e. access to finance, lack of skilled human capital, business competition, access to technology and innovation infrastructure, non-conducive government policies and weak business incentives). Using a factor analysis approach it was found that (1) accessibility to technology and innovation infrastructure, (2) non-conducive government policies and (3) lack of skilled human capital were perceived to be the major challenges facing the SMEs in the survey. Second, we examined the relationship of each of the identified challenging factors to seven demographic variables (i.e. type of business, year of establishment, ownership structure, annual sales turnover, employment size, export orientation and financing options) for the sample of SMEs surveyed. This was aimed at identifying if differences in the profile of the SMEs was significant in influencing their perception of the challenging factors. The results show that there is a significant correlation between the three challenging factors with some of the SME profiles (i.e. the type of business, export orientation and sales turnover volume).

This paper is structured as follows. Section 2 provides an overview of SME development in Malaysia. This is followed by a review of the relevant literature in Section 3. Section 4 presents the research methodology followed by an interpretation of the results in Section 5. Section 6 provides a summary and key recommendations.

2. An Overview of SME Development in Malaysia

There are various definitions of what constitutes an SME. Audrestch (1999) defined an SME as an enterprise comprised of less than 500 employees. The European Union (2003) defines an SME as an enterprise with a maximum of 250 employees and an annual

turnover not exceeding €50 million. In Malaysia the National SME Development Council provides a formal definition of an SME (refer to Table 1). SMEs are classified into two categories. First, manufacturing, manufacturing related services and agro based industries. SMEs in this category are defined as enterprises with full time employees not exceeding 150, or an annual sales turnover not exceeding RM25 million. Second, SMEs involved in services, primary agriculture and information and communications technology (ICT). SMEs in this category are defined as being enterprises with full time employees not exceeding 50, or an annual sales turnover not exceeding RM5 million (BNM, 2005).

Table 1: SME Definitions in terms of Annual Sales Turnover & Full time Employees

Size	Primary Agriculture	Manufacturing (including Agro- Based) & Manufacturing-Related Services	Service Sector (including ICT)
Annual Sales Turnover	Not exceeding RM5 million	Not exceeding RM25 million	Not exceeding RM5 million
Full Time Employees	Not exceeding 50 employees	Not exceeding 150 employees	Not exceeding 50 employees

Source: BNM (2005)

In early 2005 the National SME Development Council conducted a comprehensive survey of business enterprises in Malaysia. This found that out of the 523,132 business firms surveyed, 99.2 percent (or 518,996 firms) were SMEs. Hence they constitute the vast majority of businesses establishments and are of considerable significance to the economy. The Malaysian survey also found that SMEs formed the bulk of business establishments in the three major economic sectors – agriculture, manufacturing and services. A total of 37,866 SMEs were in the manufacturing sector, engaged primarily in textile and apparel, metal and mineral products, and food and beverage production. Some 32,126 SMEs were involved in the agriculture sector, mostly in food crops and market produce, horticulture and livestock (BNM, 2005). By far and away the most important sector of activity was in the services sector where some 449,004 SMEs operated mainly in retail, restaurants, wholesale, transportation and professional services.

Table 2 highlights the significant contribution of SMEs to employment, output, value added and output growth in key segments of the manufacturing sector. For example, SMEs in the food and beverage sector made the highest segment contribution to output (30.6%) followed by Metal and Metal products (13.6%) and then by chemical and chemical products (11.9%). While the Electrical and Electronics sector contributed 23.1 percent to total manufacturing output only 5.2 percent of this segment’s output was produced by SMEs, reflecting the dominance of MNCs in this segment.

In 2005 SMEs were the major employers in the Malaysian labour market, with over three million employees in total. This constituted 65.1 percent of total employment (see Table

2), of which 2.2 million were employed in the services sector, 740,000 in manufacturing and 131,000 in the agriculture sector.

Table 2 Contribution of SMEs to Employment, Output and value-added (%) in the Malaysian Manufacturing Sector in 2003

SEGMENT	NO. OF ESTABLISHMENTS	NO. OF SMES	CONTRIBUTION TO OUTPUT (%)	GROWTH IN OUTPUT (%)	CONTRIBUTION TO VALUE-ADDED (%)	GROWTH IN VALUE-ADDED (%)	EMPLOYMENT (%)
Food & Beverages	2,949	2,749	30.6	9.1	19.8	16.3	16.6%
Wood & Wood Products	2,776	2,582	8.3	11.5	9.6	16.3	16.2%
Rubber & Plastic Products	482	366	10.8	8.8	12.2	13.3	13.1%
Machinery & Equipments	1,249	1,135	2.9	8.9	4.2	11.3	4.1%
Transportation	507	433	2.5	-2.3	3.3	-0.5	2.8%
Textile & Apparels	3,419	3,319	2.2	1.2	3.2	4.7	7.2%
Chemical & Chemical Products	712	526	11.9	10.6	12.6	16.3	5.3%
Metal & Metal Products	2,918	2,709	13.6	-	13.9	-	12.9%
Electrical & Electronics (E&E)	907	543	5.2	-	5.1	-	5.8%
Non Metallic Mineral Products	893	803	4.8	10.5	6.6	13.7	-

Source: SMIDEC, NPC, Saleh and Ndubisi (2006)

In terms of their overall contribution to national output, SMEs are one of the major contributors. For instance, in 2003, SMEs in Malaysia generated a total of RM154 billion of value-added and RM405 billion in total output. SMEs in the services sector contributed 54.7 percent of total value-added, followed by the agriculture sector (39.7 percent) and the manufacturing sector (37.1 percent). In 2005, as shown in Table 3, SMEs in Malaysia contributed 47.3 percent of GDP/total value-added. This contribution was comparable to the contribution made by SMEs in other developed Asian countries such as in Japan (55.3 percent), Korea (50 percent in 2002) and Singapore (34.7 percent) (BNM, 2005). Furthermore, SMEs play a vital role and contribute significantly to GDP as well as to the total workforce in these countries. For example in Korea, 99.8% of total establishments are SMEs, contributing to 86.7% of the total workforce.

In terms of geographical location the majority of manufacturing companies in Malaysia are located on the west coast, a highly industrialised area. SMEs in Selangor are predominant in the transport equipment and electrical sectors, arising from the availability of appropriate infrastructure in this state. However, in Johor the textiles and apparel and wood-based industries are dominated by SMEs, due to the availability of cheap labour and logging activities in the area. Food and food related manufactures are concentrated in the states of Perak and Johor.

Table 3 SMEs profile – Selected countries*

Countries	% of total establishments	% of total Work force	Contribution to GDP/total value added
Japan	99.7	70.2	55.3
Singapore	91.5	51.8	34.7
Germany	99.7	79.0	57.0
Korea	99.8	86.7	50
Malaysia	99.2	65.1	47.3

Source: BNM (2005)

Note: * The data was based on the following sources: For Malaysia, Malaysia Census (2005); For Japan, JASME Annual Report (2004-2005), (<http://www.jasme.go.jp>); For Korea, Korean SMEs (2002), (<http://www.smba.go.kr>); For Singapore, APEC - SME Profile (<http://www.actetsme.org>); For Germany, SMEs in Germany - Facts and Figures (2004), (<http://www.ifm-bonn.org>).

3. Literature Review

While the contribution of SMEs to the economic development, growth, employment and exports of Malaysia has been important, recent debate in the literature has focused upon the challenges that they face and must overcome if they are to maintain this important role. Some of the earlier studies on Malaysian SMEs in regard to these challenges have provided a somewhat broad understanding of the issues (see, for example, studies by APEC, 1994; BNM, 2005; SMIDEC, 2002; Ting, 2004; UPS, 2005; and Saleh and Ndubisi, 2006). APEC (1994), for example, highlighted key challenges relating to obtaining loans, a lack of proper coordination amongst the country's SME development agencies, an inability of SMEs to participate in the mainstream of industrial development, underutilization of available technical assistance and other incentives and a lack of skilled and talented workers. SMIDP in its 2001-2005 report (SMIDEC, 2002) identified many new challenges facing Malaysian SMEs both at the domestic and international levels. These challenges can be summarized as follows:

- *Intensified global competition.*
- *Competition from other producers (e.g. China, India)*

- *Limited capability to meet the challenges of market liberalisation and globalisation*
- *Limited capacity for technology management and knowledge acquisition*
- *Low productivity and quality output*
- *Shortage of skills for the new business environment*
- *Limited access to finance and capital, and the infancy of venture funds in initial or mezzanine financing*
- *High cost of infrastructure*
- *General lack of knowledge and information*

In addition, Ting (2004) argued that the challenges for Malaysian SMEs also include human resource constraints; lack of access to finance; inability to adopt technology and lack of information on potential markets. The author also argued that Malaysian SMEs are in a critical position to be wiped out if they do not improve their competitiveness in the near future. UPS (2005) conducted a pilot study of 100 Malaysian SMEs and found that labour cost, innovation and access to funding and working capital are the main challenges facing Malaysian SMEs. In addition, Saleh and Ndubisi (2006) identified a number of key challenges facing Malaysian SMEs:

1. High levels of bureaucracy in government agencies hindering efficient business development.
2. Difficulty in obtaining funds from financial institutions and as well as from the government.
3. Lack of and cost of professional and skilled workers.
4. High level of international competition due to globalization; including competition from AFTA member countries, from MNCs or rapidly developing new competitors (e.g. enterprises from China and India).
5. Limited access to better technology and ICT.

In sum, while past studies have provided a broad understanding of the challenges facing SMEs in Malaysia, these were rather haphazardly done and without any solid empirical foundations. This study fills this gap by conducting an empirical analysis of the significance of the major challenges affecting SME business performance in Malaysia.

4. Methodology

The Sample Size

The results from this study were derived by means of a survey instrument distributed to a total of 500 randomly selected SMEs in Malaysia. The selection of the sample SMEs was not limited to companies undertaking any particular type of business. However, the sample was restricted to SMEs operating in the state of Selangor only, as this state has the largest number of SME establishment in Malaysia (SMIDEC, 2006). Further, due to resource limitation, a country-wide survey is not possible at present. The details of the SMEs were obtained from the Federation of Malaysian Manufacturers (FMM) Directory 2005.

The Survey Instrument

A questionnaire was sent to the CEO/managing director of the sample SMEs. This is because the perception of the challenges that hinder business performance is best understood by the person heading the top management team. The CEOs, however, had the discretion of appointing a proxy to answer the questionnaire. The questionnaire was accompanied by a stamped self-addressed return envelope in which the respondents were invited to return the completed questionnaire.

The cover page of the questionnaire contains information on the survey, its objectives as well as the issue of confidentiality and anonymity relating to the respondents. The questionnaire is then divided into two sections - Section A and Section B. Section A seeks general information (demographic profile) of the sample SMEs, such as the core business area, year of establishment, ownership structure, position of the person answering the question, annual sales turnover, employment size, whether the SMEs are exporting their products and the financing options for the SME. Section B is divided into six sub-components. This section consists of perception questions pertaining to the financial, human capital, business competitiveness, availability of infrastructure, government policies and incentives given to the SMEs.

Data Analysis

Analysis of the completed questionnaire was conducted in three facets using the SPSSWIN software. First, a frequency distribution analysis was conducted to determine the demographic profile of the sample SMEs. Second, reliability and factor analysis was conducted to determine the reliability of the instruments used and the determination of the pertinent challenging factors to the SMEs. Third, a correlation test was undertaken to examine the relationship between the challenging factors and the demographic profile of the sample SMEs.

5. Results

In this section the results from the analyses are given. The results of the demographic profile of the sample SMEs are first discussed, followed by discussion of the factor analysis. The last section provides an analysis of the correlation between the demographic profile and the challenging factors for the sample of SMEs.

Sample Response Rate

A total of 138 companies responded to the questionnaire (a response rate of 27.6 percent). This response rate is slightly over the usual response rate in Malaysian based surveys (ranging from 15-25 percent) (see, for example, Sarachek and Aziz, 1983; Rozhan, 1991; and Kanapathy and Jabnoun, 1998).

Profile of Sample SMEs: Frequency Distribution Analysis

A frequency distribution analysis was conducted for the items in Section A (demographics of the respondents) of the questionnaire. Tables 4 – 12 given in the appendix, show the frequency analysis results. It can be seen from Table 4 that the majority of the sample of SMEs are in the food and beverages (28.5 percent) and wholesale and retail trade (15.2 percent) industries. Further, Table 5 shows that most of the sample SMEs were established during 1990s (63 percent), 34.8 percent were formed during the 1980s, and only 2.2 percent SMEs were established since the 1970s. In terms of ownership structure (Table 6), 92.1 percent of the sample SMEs (127 companies) are wholly Malaysian owned firms, while 7.2 percent (10 companies) of the SMEs are wholly foreign owned firms. Only one SME (0.7 percent) has a joint venture ownership structure. Table 7 shows that 86 (62.3 percent) of the sample SMEs are exporters, while 52 (37.7 percent) are non exporters. Table 8 shows that in terms of export location, most companies selected had more than one export location. Thus the frequency analysis is shown in terms of the percentage of the 86 sample companies exporting to each geographic location. In this context, it was found that 37 sample companies (43 percent) export their products to North America, 22 companies (25.6 percent) are exporting to South America, 84 companies (97.7 percent) export their products to the Asia Pacific region, while 56 companies (65.1 percent) are exporting to the South Pacific region. Further, 7 companies (8.1 percent) are exporting to Africa, 17 companies (19.8 percent) are exporting to the Middle East, and 33 companies (38.4 percent) are exporting to European countries.

As for the question relating to the person answering the questionnaire, a total of 104 or 75.4 percent of the questionnaires were answered by the general manager of the SMEs, followed by 23 or 16.7 percent CEO/Director respondents (see Table 9). Nearly 3 percent or 4 questionnaires were answered by the administration manager. Meanwhile 5.1 percent, or 7 questionnaires, were answered by other staff members.

The bulk of the sample SMEs (57.2 percent) generated an annual sales turnover ranging between RM1 – RM5 million (see Table 10). Another 21 percent of the SMEs experienced annual sales ranging between RM5 - RM10 million, followed by 18.1 percent SMEs with annual sales of RM200, 000 – RM1 million. Only 2.9 percent, or 4 SMEs, experienced annual sales of RM10 – RM25 million. Lastly, one SME (0.7 percent) generated sales turnover of less than RM200, 000 per annum.

For questions related to the number of employees the majority of the SMEs (43.5 percent) employed between 20 – 50 workers (see Table 11). This was followed by 37 percent of SMEs employing between 5 – 20 workers and another 17.4 percent employing between 50 – 150 employees. Only three SMEs (2.2 percent) employed less than 5 workers.

Finally, questions relating to financing options revealed that most of the sample SMEs selected more than one source of financing (see Table 12). The results also show that most SMEs obtain their financing from commercial banks (92 percent or 127 companies). Nearly 72 percent of the SMEs (99 companies) use their own funds to finance their

business while 42.8 percent (59 companies) obtain funding from microfinance institutions (MFIs) in Malaysia. Only a small percentage (5.1 percent or 7 companies) of the SMEs obtained funding from Islamic based financial institutions.

Factor Analysis

Reliability of the Instruments

In this study we conducted a reliability analysis (SCALE procedure) on the instruments used by means of SPSSWIN. The literature highlights that the standard acceptance value for the Cronbach alpha reliability test should be above 0.70 (Othman *et al.*, 2000). The finding shows that the instruments used in this study obtained a Cronbach alpha of 0.724, denoting that the instruments were reliable measures to identify the perception of the SME challenges.

Typology of the Challenges Perception

In this section the results from the factor and reliability analysis are presented. Table 13 provides the means and standard deviations of the scores related to each of the variables used in the factor analysis. A total of 20 variables show mean scores ranging from 3.00 – 3.80 points². The balance variables shows mean scores ranging from 2.70 – 2.99 points. For example, variables related to SME difficulty in getting financial aid, certain policies reduce business opportunities, high level of competition from MNCs, not getting sufficient government support and problems with legal protection related to property rights, obtains mean scores of 3.72, 3.59, 3.57, 3.52 and 3.49, respectively. The variable related to government support for product innovation gives the lowest mean score of 2.77 of the 138 variables tested.

The factor analysis yielded five factors that represent the major challenges facing the sample of SMEs, based on their perceptions. The factors were labelled as inaccessibility to finance; lack of skilled human capital; Business competition; Inaccessibility to technology and innovation; and Non-conductive government policies. However, the low Cronbach alpha value for the first ($\alpha = 0.631$) and last factors ($\alpha = 0.668$) prevented their usage in the analysis. Hence, only the resulted for the three remaining factors are reported which are labelled as the First Challenging Factor, Second Challenging Factor and Third Challenging Factor respectively. The correlation between these three factors was also examined but no statistically significant correlation was found. This indicates that these factors are independent of one another.

The Bartlett test of sphericity was used to test the null hypothesis of the variables is uncorrelated in the population. The test shows a value of 2822, denoting that the null hypothesis can be rejected. Thus, the variables used are correlated with the population. The Kaiser-Meyer-Olkin (KMO) measure of sampling adequacy was also computed and the result shows a value of 0.623, indicating that factor analysis is highly appropriate.

²Highlighted in bold in Table 13.

First Challenging Factor

The First Challenging Factor is labelled as **Inaccessibility to Technology and Innovation Infrastructure**. This factor contains five items, with a Cronbach alpha value of 0.823 (refer to Table 14). The importance of the six items within the First Challenging Factor is based on the magnitude of the factor loading value. On this basis the sample SMEs perceive a lack of access to technology and ICT infrastructure due to high cost as being the most critical challenge. The factor loading for this item is 0.772. Second, SME difficulty in obtaining raw materials and capital is perceived as the second most critical challenge, with a factor loading for this item of 0.719.

The third important challenge is related to the lack of R&D infrastructure availability the sample SMEs (with a factor loading of 0.682). Lack of access to information that promotes good business development among the SMEs is perceived as the fourth critical challenge (with a factor loading of 0.672). The last challenge is related to the legal protection of intellectual property rights in Malaysia (with a factor loading of 0.610).. Here, SMEs perceive that the patenting of creative ideas into a formidable intangible asset is a difficult process. This hinders innovation in the operation of the business.

Second Challenging Factor

The Second Challenging Factor is labelled as **Non-Conducive Government Policies** (refer to Table 15). This factor contains five items. The reliability test shows a Cronbach alpha of 0.802, denoting high reliability of the items. These items are ranked in accordance to the magnitude of the factor loading. The first item in this factor is related to high bureaucracy in the government delivery system that hinders efficient business operations for the SMEs, with a factor loading of 0.810. This is followed by the second most critical challenge – SMEs not getting sufficient government support to undertake their business (a factor loading of 0.731). The third important challenge is the handling of incentives or grants offered by different agencies that creates confusion for the SMEs. The factor loading for this item is 0.701. This is followed by unpredictable policy changes by the government that creates operational problems for the SMEs (a factor loading of 0.665). The last item of importance is related to policies that are perceived to reduce business opportunities for SMEs (with a factor loading of 0.627).

Third Challenging Factor

The Third Challenging Factor contains four items (refer to Table 16). The Cronbach alpha value is 0.797, indicating high reliability. This factor is labelled as **Lack of Skilled Human Capital**. The sample SMEs perceive human capital issues as the third major challenge hindering their business performance. The first item in this factor is the perception of low level managerial or administration skills among the SMEs' workforce. The second item that is considered an important challenge for SMEs is the lack of experience/skill in dealing with international business counterparts. The factor loading

for both the first and second items is 0.787. The third critical challenge is the issue of low innovation or creativity among SME workers in Malaysia (with a factor loading of 0.746). A fourth critical challenge is the poor productivity of the SME workforce (with a factor loading of 0.665). Finally, the cost of employing professional and competent employees to work in the SMEs is seen as being problematic (with a factor loading of 0.667).

Relationship between the Challenging Factors and the Demographic Profiles

The second objective of this study is to analyse the relationship between the challenging factors and the seven demographic profiles of the sample SMEs. The findings are presented in Table 17. Such a relationship is examined using the Pearson correlation test.

First Challenging Factor

The correlations show that the First Challenging Factor (Inaccessibility to Technology and Innovation Infrastructure) has a positive and significant relationship with the type of business, annual sales turnover, and export orientation variables. These relationships are statistically significant at the 1 percent significance level. The other four variables have a positive but insignificant relationship with the First Challenging Factor.

These results imply that SMEs involved in highly technical based business (such as manufacturing) require high tech machinery and equipment in their production process. Lack of accessibility to the necessary technological and innovation infrastructure (due to high cost of acquisition, lack of interest in R&D by the company, lack of information accessibility, difficulty in accessing raw materials, or low intellectual property protection mechanisms) have become critical challenges for SMEs in Malaysia. Further, lack of accessibility to technology and innovation infrastructure may also affect SME annual sales volume, as they may not be able to attain wider market share, increase their production efficiency and productivity and escalate their labour productivity. Finally, lack of access to technology and innovation infrastructure may also not permit SMEs to export their products and services to overseas markets. This is because non-innovative business may not be able to produce innovative and niche products and services that can compete in overseas markets.

Second Challenging Factor

The Second Challenging Factor (Non-Conducive Government Policies) shows a positive and statistically significant relationship (at the 10 percent level) with the export orientation variable. This implies that some of the current government policies towards SMEs may not adequately encourage or facilitate them in exporting their products or services. For example, a high sales tax rate imposed by any government may not spur SMEs to venture into foreign markets (exporting their products). The other six variables have a positive but insignificant relationship with the Second Challenging Factor.

Third Challenging Factor

The Third Challenging Factor (Lack of Skilled Human Capital) has positive and statistically significant relationship (at the 1 percent level) with two variables, namely the type of business and annual sales turnover. This shows that lack of skilled human capital does not augur well in terms of the type of business that the SMEs operates in and their sales volume. This may be because of the fact that certain types of business activity requires a highly skilled workforce that can handle either complicated production processes or complex administration tasks. Lack of skilled human capital for this type of business will certainly pose a challenge for SMEs. A lack of skilled human capital also may not help SMEs increase their sales turnover volume due to weak operational efficiency (as a lack of skilled labour will not facilitate improvements in the company's operational efficiency) and provide a barrier to the further expansion of the business. The relationship between this factor and the other five variables was positive but insignificant.

6. Conclusions and Recommendations

Earlier studies pertaining to Malaysian SMEs provided a broad understanding about the challenges that they faced in the conduct of their business. However, these studies generally lacked empirical foundation and did not attempt to classify business challenges into certain groups. Hence, this explanatory study has classified business challenges into six major factors namely, accessibility to finance, lack of skilled human capital, business competition, accessibility to technology and innovation infrastructure, non-conducive government policies and weak business incentives. Further, an empirical analysis was conducted to determine the most critical of these challenges to SMEs.

As discussed earlier each one of these factors contained five items. The importance of each factor and the underlying items were classified and sorted according to the magnitude of the factor loading. The results show that issues related to inaccessibility of technology and innovation infrastructure (labelled as the first challenging factor), non-conducive government policies (labelled as the second challenging factor) and lack of skilled human capital (labelled as the third challenging factor) are perceived to be the major challenging factors for SMEs in the sample of SME from Selangor. The government should, therefore, offer more policies and incentives to enhance ICT readiness, facilitate more widespread use of ICT applications and e-business uptake by small firms. Government should also educate SMEs on the incentives available to them and how to access them. The government should strengthen its role in improving basic ICT skills, develop a framework to encourage higher level ICT and e-business skills adoption in education institutions, businesses and by individuals.

Further, the Malaysian government needs to encourage rollout of affordable quality broadband networks to underpin the competitiveness and growth of SMEs. There should be a continuous effort to liberalise network infrastructure and services that promotes competition in the telecommunications sector. Where the need exists, and without pre-empting private initiatives or inhibiting competition, government should complement

private investment with public financial assistance to expand coverage for under-served groups and remote areas.

Another important point is the problem related to legal protection and intellectual property rights. Government should enhance SME awareness and knowledge of all elements of the intellectual property system. These include patents, trademarks, industrial designs, utility models, trade secrets, copyright and related rights, plant varieties and non original databases. There should be concentrated efforts to strengthen the teaching of intellectual property rights at universities and training institutions for entrepreneurs, engineers, scientists, designers and business managers. Government can also facilitate the use of the intellectual property system by promoting the development of cost-effective mechanisms for application and for the resolution of intellectual property disputes. These include opposition procedures, arbitration and mediation. Further, the Malaysian government can consider developing a niche market for intellectual property insurance as a tool for reducing the costs of litigation for SMEs, identify existing barriers to this development and determine the scope and form of government intervention to remove them.

Another key finding in this study is the high bureaucracy level in government operations and insufficient government support and handling of incentives/grants through a multitude of agencies. These were found to be the most critical challenges for sample SMEs to flourish. Hence, the government should dismantle the bureaucratic procedures that cause inefficiency in government initiatives and projects. The government should also avoid delivering incentives through so many different agencies.

Other important challenges were related to the low level of administrative skills in the workforce, lack of experience of the workforce in dealing with foreign business, and not much innovation among the workforce. These were the most critical challenges for sample SMEs under the third challenging factor (lack of skilled human capital). The government should act here by increasing the number of centres across the country that offer training, consultancy and expert services to SMEs to increase the skills of their managerial team as well as manpower especially in regard to ICT usage. Setting up the SME special unit at bank Negara Malaysia (BNM), SME bank (October 2005) etc was a good step in this regard.

Thus, identification of the major business challenges (or problems) that SMEs encounter will prove to be beneficial both to the SME sector and to the government. However, identification of the problems will not be useful if no swift rectification actions are taken. This study has provided some pertinent recommendations that can be adopted to minimize the challenges.

Appendix

Table 4: Type of Business SMEs are involved

Type of Business	Percentage
Textiles and wearing Apparel	10.9
Food and beverages	28.5
Furniture and related products	8.7
Footwear and leather products	10.1
Transportation	10.9
Wholesale and retail trade	15.2
Gift ware and jewelry	3.6
Household products and appliances	8.7
Others	3.6

Table 5: SMEs year of establishment

Year of Establishment	Percentage
1970s	2.2
1980s	34.8
1990s	63

Table 6: SMEs ownership structure

Ownership structure	Percentage
100% Malaysian owned	92.1
100% foreign owned	7.2
Joint local/foreign owned	0.7

Table 7: Exporting and Non-Exporting SMEs

Exporting	Non-Exporting
86 SMEs	52 SMEs

Table 8: Regional Distribution of SMEs Export Market (%)

Export Market	Percentage
North America	43
South America	25.6
Asia Pacific	97.7
South Pacific	65.1
Africa	8.1
Middle East	19.8
Europe	38.4

Table 9: Respondent's current position in the SME

Current Position	Percentage
CEO/Director	16.7
General Manager	75.4
Administration manager	2.9
Others	5.1

Table 10: SMEs annual sales turnover

Annual Sales Turnover	Percentage
Less than RM200,000	0.7
Between RM200,000 – RM1 million	18.1
Between RM1 – RM5 million	57.2
Between RM5 – RM10 million	21
Between RM10 – RM25 million	2.9

Table 11: Number of employees in SMEs

Number of employees	Percentage
Less than 5 employees	2.2
Between 5 – 20 employees	37
Between 20 – 50 employees	43.5
Between 50 – 150 employees	17.4

Table 12: Source of Financing for SMEs

Source of Financing	Percentage
Commercial banks	92
Islamic banks	5.1
Personnel funds	71.7
Microfinance institutions (MFIs)	42.8

Table 13: Mean Score and Standard Deviation of the Variables

No	Variables	Mean	Std. Deviation
1	SME difficulty getting financial aid	3.72	0.639
2	Certain policies reduce business opportunity	3.59	1.086
3	SME faces high level of competition from MNCs	3.57	0.827
4	SME not getting sufficient government support	3.51	0.953
5	Problems with legal protection of property rights	3.49	0.766
6	Expensive to employ professional employee	3.45	0.736
7	Lack of access to information hinders growth of SME	3.4	0.859
8	Lack of access to ICT hinders efficient business operations	3.36	0.861
9	Workforce lack experience/skill dealing with foreign businesses	3.29	0.873
10	Products of SME face high competition from overseas products	3.28	0.863
11	High cost running businesses reduces competitive power	3.26	0.738
12	Interest charged on loans high	3.23	0.676
13	High bureaucracy level in government hinders efficient operations	3.23	0.969
14	SME faces difficulty getting access to raw materials & capital	3.22	0.98
15	Handling of incentives/grants by multitude agencies creates confusion	3.2	0.968
16	Global issues challenge Malaysian SMEs	3.17	0.828
17	Not much focus on R&D infrastructure in SMEs	3.17	0.933
18	Unpredictable policy changes creates problem for SME	3.17	0.971
19	Not much avenue for accessing international market	3.14	1.022
20	Not much innovation among workforce	3.05	0.931
21	Too many processes involved	2.99	0.745
22	Not enough effort for promotion of products	2.96	0.883
23	Financial products not in pace	2.94	0.817
24	Low level of admin skill in workforce	2.92	0.802
25	Government support for ILP is adequate for SMEs development	2.91	1.126
26	Government support for promoting SME products is adequate for development	2.89	1.085
27	Labour productivity is low	2.88	0.778
28	Government support for human capital is adequate for development	2.83	0.903
29	Current government policies on SMEs are adequate in development of SME	2.78	0.959
30	Government support for SMEs for product innovation is adequate for development	2.77	0.898

Table 14: First Challenges - Inaccessibility to Technology and Innovation Infrastructure

	Factor loading
First Challenges: alpha = 0.823	
Lack of access to ICT hinders efficient business operations	0.772
SMEs face difficulty in getting access to raw materials & capital	0.719
There is not much focus on R&D infrastructure provision to SMEs in Malaysia	0.682
There is lack of access to information that hinders growth of SMEs	0.672
There exist various problems in legal protection of intellectual property rights	0.610

Table 15: Second Challenges – Non-Conductive Government Policies

	Factor loading
Second Challenges: alpha = 0.802	
High bureaucracy level in government hinders efficient operations	0.810
SMEs not getting sufficient government support	0.731
Handling of incentives/grants by multitude agencies creates confusion	0.701
Unpredictable policy changes creates problem for SMEs	0.665
Certain policy reduces business opportunity	0.627

Table 16: Third Challenges – Lack of Skilled Human Capital

	Factor loading
Third Challenges: alpha = 0.797	
Low level of admin skill in workforce	0.787
Workforce lack experience/skill dealing with foreign businesses	0.787
Not much innovation among workforce	0.746
Labour productivity in Malaysian SMEs workforce is low	0.665
Expensive to employ professional employee	0.522

Table 17: Correlation between the Challenging Factors and the Demographic Profiles of SMEs

Challenging Factors	Type of Business	Year of Establishment	Ownership Structure	Annual Sales Turnover	Employment Size	Export Orientation	Financing Options
Factor 1	0.026*	0.034	0.136	0.021*	0.145	0.088*	0.332
Factor 2	0.285	0.113	0.169	0.066	0.186	0.220**	0.041
Factor 3	0.071*	0.177	0.003	0.022*	0.151	0.054	0.211

* and ** shows significance at 1% and 10% level respectively

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