

Chapter 3

Productivity Performance of SMEs



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With SMEs representing 99.2% of total business establishments and employing over 5.6 million workers, developing a competitive, productive and resilient SME sector is an important thrust to support the Government's aim of achieving balanced economic development and higher standards of living at all levels of society.

1. Government Strategies Driving SME Development

SME's Contribution to the Economy

| Performance of SMEs | 2005(%) |
|----------------------------------|---------|
| SMEs' contribution to GDP | 32.0 |
| SMEs' contribution to employment | 56.4 |
| SMEs' share of total exports | 19.0 |

Source: Census of Establishments and Enterprises 2005

SMEs promote private ownership and entrepreneurship, provide broad based growth whilst also acting as incubators for developing domestic enterprises into large corporations. In developed Asian countries like Japan and PR China, SMEs' contribution to the GDP is already above 55% compared to 32% recorded by Malaysian SMEs. The Government has accorded high priority to the development of SMEs to fully realise their potential. The commitment of the Government is reflected in the national development agenda. Both the Ninth Malaysia Plan (9MP) and the Third Industrial Masterplan (IMP3), outline key strategies for SME development for the 2006-2010 and 2006-2015 periods respectively.

Key Strategies For Growth

The Ninth Malaysia Plan (9MP) and the Third Industrial Masterplan (IMP3) have outlined key strategies and thrusts to help SMEs move up the value chain, with a special focus on Information and Communications Technology (ICT), capacity building and enhanced productivity.

The Ninth Malaysian Plan (9MP)

During the 9MP period from 2006-2010, the principal SME policy is the development of a competitive, innovative and technologically strong SME sector able to compete in a global market. Strategies are directed at the acquisition of technologies to propel SMEs up the value chain in the manufacturing, agriculture and services sectors. These include:

- **Outsourcing**

Programmes will be implemented to nurture SMEs as research and development (R&D) partners. Collaborative ventures among Multi National Corporations (MNCs), Government Link Corporations (GLCs) and SMEs will facilitate technology transfer and skills development and marketing opportunities;

- **Inter-firm Linkages**

Creating business links between SMEs, GLCs and MNCs would enable SMEs to be more competitive and become reliable suppliers for global outsourcing networks which would expand Malaysia's trade with new export markets;

- **Entrepreneurship Programmes**

Programmes, including advisory and outreach services, will be expanded to equip SMEs with new and improved management and business practices methods in production, quality improvement, marketing and distribution; and

- **Knowledge Skills**

Further development of technical skills amongst SMEs, especially in generating innovation and creating economic value from knowledge application.

The Third Industrial Masterplan (IMP3)

IMP3 outlines five clear strategies on strengthening the economic foundation of SMEs in the manufacturing, agriculture and services sectors. These are:

- **Enhancing Competitiveness**

To enhance competitive advantage, SMEs are encouraged to integrate with MNCs, capitalising on the current outsourcing trends among large corporations especially in high value added activities. SMEs need to move up the value chain through rationalisation and specialisation, focusing on building and enhancing core competencies to compete regionally and globally. Specialisation will enable SMEs to better leverage on the core competencies to create a market niche, both domestically and overseas;

- **Capitalising on Outward Investment Opportunities**

With the advent of a more liberalised market, SMEs can no longer rely on domestic demand. A more integrated global market provides new opportunities and greater export opportunities for those who are proactive. Financial institutions are urged to provide loans towards new investments overseas especially in the Association of the Southeast Asia Nations (ASEAN) region. This will go hand in hand with efforts from various Agencies such as the Small and Medium Industries Development Corporation (SMIDEC) and the Malaysian External Trade Development Corporation (MATRADE) who will initiate closer bilateral cooperation with foreign counterparts, promote industry linkages, joint trade commissions and exhibitions to facilitate networking between local and foreign SMEs;

- **Focus on Technology and Innovation**

In line with global trends, growth amongst domestic SMEs will inevitably be driven by technology and innovation. The emergence of new technology and products have influenced the way business is now conducted. As such, high priority has been given to strengthen the technological capabilities of SMEs. SMIDEC in collaboration with technology-based institutions like SIRIM Bhd (SIRIM), Malaysian Technology Development Corporation (MTDC), Multimedia Development Corporation (MDeC) and Malaysia Biotechnology Corporation will introduce technology foresight programmes that allow SMEs to take advantage of available technology;

- **Providing a Cohesive and Supportive Regulatory and Institutional Framework**

To achieve a higher rate of success the approach has to be systematic and coordinated. This synchronised approach is to be carried out hand in hand with financial support programmes which include:

- Assisting potential entrepreneurs to upgrade technical and professional skills;
- Assisting in the purchase of new machinery and equipment;
- Providing industrial sites and special parks at competitive prices;
- Providing assistance in the registration and patenting of Intellectual Property (IP);
and
- Reducing red tape for faster processing.

- **Nurturing the Services Sector**

The Census of Establishment and Enterprises 2005 indicated 86.5% of SMEs are in the services sector. Several areas for growth have been identified within this sector:

- Distributive trade - increasing new products and services for franchising;
- Business and professional services - encouraging entrepreneurs in specialist skills such as pharmacies and dental clinics;
- Logistics services - increased SME participation in the integrated logistics supply chain;
- Construction and related services - SMEs to link with large construction companies to form a strong domestic sub-contracting base to secure contracts locally and overseas; and
- ICT - stimulate growth of technopreneurs and SMEs by providing seed and start-up funding.

2. Productivity Performance of SMEs

Given the Government's adoption of a more comprehensive approach towards SME development such as increasing access to financing, strengthening enabling business infrastructure, enhancing the capacity and capability of SMEs including providing greater access to business support services locally and abroad, the way forward for SMEs is to move up the value chain to remain competitive. These measures have helped in part to raise productivity levels across the three main sectors of the economy.

The way forward for SMEs is to move up the value chain to remain competitive

a. The Manufacturing Sector

In 2007, 96% of establishments in the manufacturing sector were SMEs, contributing 30.7% of total manufacturing output and 26.3% of total value added. In addition, more than 400,000 or 31.6% of the total workforce was employed in this sector.

Total Output, Value Added and Employment of SMEs

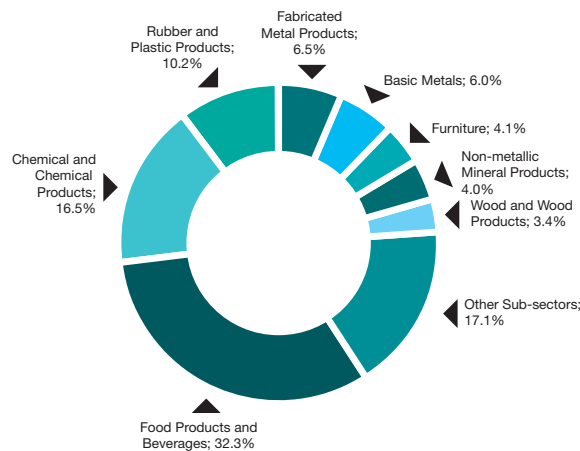
| | Value Level* | | Percentage Share of Manufacturing Sector (%) | | Growth (%) |
|---------------------|--------------|---------|--|-------|------------|
| | 2006 | 2007 | 2006 | 2007 | 2006-2007 |
| Total Output | 88,266 | 94,356 | 29.31 | 30.74 | 4.91 |
| Value Added | 17,798 | 19,251 | 25.66 | 26.33 | 8.16 |
| Employment | 402,496 | 413,397 | 31.21 | 31.62 | 4.91 |

*Value Levels for Total Output and Value Added are in RM million

Source: Annual Survey of Manufacturing Industries, Department of Statistics, Malaysia, various issues

Given its size in terms of output, the food products and beverages sub-sector recorded the largest contribution among SMEs, accounting for 32.3% share of total output. This was followed by chemicals and chemical products which recorded a 16.5% share, rubber and plastic products 10.2% of share and furniture 4.1% share of the total output. These industries accounted for 63%, valued at RM59.5 million, of total output by SMEs in 2007.

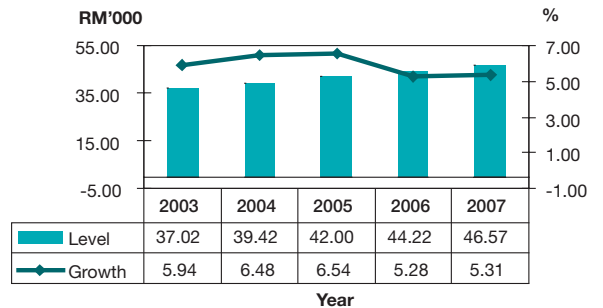
Distribution of SMEs' Output in the Manufacturing Sector



Source: Annual Survey of Manufacturing Industries, Department of Statistics Malaysia

In 2007, the growth in productivity of SMEs stood at 5.3%, with a value of RM46.6 million up from RM44.2 million the previous year. The productivity gain was attributed to higher value-added creation and capacity utilisation in selected sub-sectors. The high productivity growth mainly in the Chemicals and Chemical Products (11.4%) and Petroleum Products (8.4%) sub-sectors was due to continued investments in modern technology and advanced production processes which led to the delivery of higher value added products and services.

Productivity of SMEs

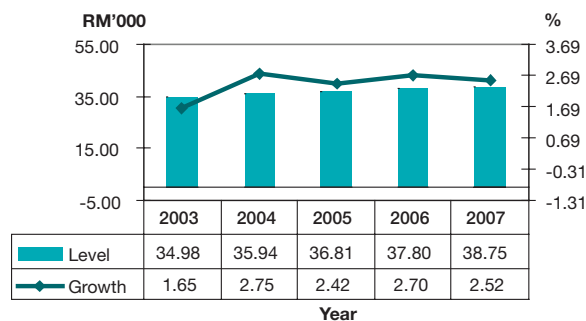


Source: Annual Survey of Manufacturing Industries, Department of Statistics Malaysia

Capital Intensity

Capital intensity or fixed assets per employee valued at RM38,753 in 2007, registered an increase of 2.5% from RM37,800 in 2006. Investments in machinery and equipment such as precision machining and tooling, process and product engineering helped sustain the steady growth recorded over the past four years. The most capital intensive activities among SMEs were recorded in the manufacture of chemicals and chemical products which recorded RM113,460 per employee, followed by non-metallic mineral products which recorded RM98,775 per employee and petroleum products which recorded RM87,850 per employee. The sub-sector that achieved the highest growth of 7.2% in capital intensity was publishing, printing and reproducing recorded media, resulting from the continuous automation technology and upgrading process that took place in this sub-sector.

Capital Intensity

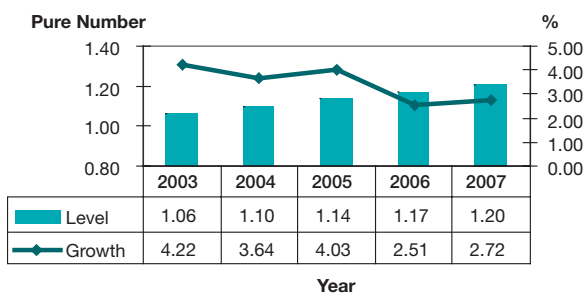


Source: Annual Survey of Manufacturing Industries, Department of Statistics Malaysia

Capital Productivity

Capital productivity also registered an upward improving trend. The key drivers of capital productivity growth among SMEs were found in the sub-sectors, led by SMEs in the wood and wood products, which achieved capital productivity growth of 8.3%, due to efficient utilisation of machinery and equipment through better maintenance and preventive methods. This has improved the capacity and capability of SMEs to deliver products and services that meet global market standards and provide customer satisfaction.

Capital Productivity



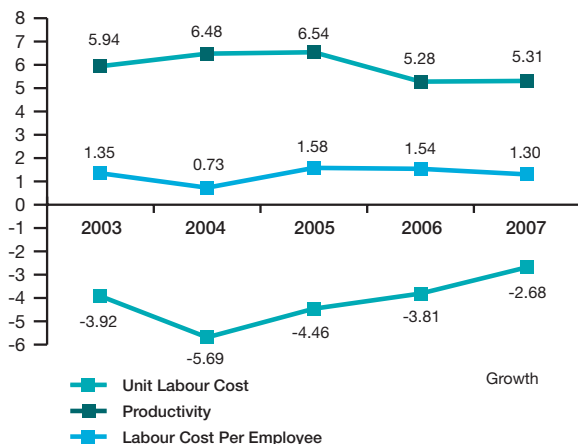
Source: Annual Survey of Manufacturing Industries, Department of Statistics Malaysia

Labour Cost Competitiveness

Labour cost competitiveness of SMEs in the manufacturing sector continued to improve in 2007, with a 2.7% decline in unit labour cost. This is shown by higher growth of productivity of 5.3%, as compared with labour cost per employee of 1.3%. The higher productivity growth compared to labour cost per employee indicates that the cost of producing one unit of output had improved.

In line with Government strategies to build resilient and global competitive organisations, SMEs are encouraged to undertake initiatives such as Quality Environment (QE), Continuous Improvement (Kaizen), Innovative and Creative Circles (ICC) and Quality Management Systems, to enhance their productivity and competitiveness.

Labour Cost Competitiveness of SMEs (2003 - 2007)



Source: Annual Survey of Manufacturing Industries, Department of Statistics Malaysia

b. The Agriculture Sector

The agriculture sector contributes significantly in terms of both national revenue and employment; delivering 7.7% of the GDP and 12.1% of total employment in 2007. The sector generated export earnings of RM82 billion as a result of favourable commodity prices in the international market. In addition, the sector recorded a productivity growth of 2.8% in 2007.

Structurally, the agriculture sector comprises of estates or plantation companies and the SMEs in the farming sector. The plantation companies are primarily involved in the cultivation of export oriented crops such as oil palm and rubber. The SMEs are mainly involved in the cultivation of both food and non-food crops, livestock breeding, fisheries and aquaculture.

Participation of SMEs According to Crop Cultivation

Based on the national census for the agriculture sector in 2005, a total of 526,257 SMEs are involved in the cultivation of the following types of crops:

| | |
|-----------------------------------|-------|
| Fruits | 30.0% |
| Industrial Crops ¹ | 29.5% |
| Paddy | 29.4% |
| Vegetables | 7.7% |
| Cash crops | 2.6% |
| Herbs and spices | 0.9% |
| Forest plantation and other crops | 0.1% |

¹ The industrial crops refer mainly to oil palm, rubber and cocoa

Productivity of the SMEs in the agriculture sector can be measured in terms of land and labour productivity.

Land and Labour Productivity for Selected Crops and Fruits

Land productivity measures the amount of agricultural output harvested from each hectare of land². Land productivity for selected crops and fruits in 2007 include:

| Crops/Fruits | Yield per hectare per annum (tonnes) |
|--------------|--------------------------------------|
| Tomato | 59.0 |
| Oil palm | 19.0 |
| Dragon Fruit | 16.5 |
| French Bean | 14.4 |
| Chilli | 12.3 |
| Durian | 7.9 |
| Maize | 6.5 |
| Mango | 5.0 |
| Rubber | 1.4 |
| Cocoa | 0.9 |

² One hectare is equal to 2.47 acres



Labour productivity measures the amount of agricultural output harvested by each worker per man-day. Labour productivity for selected crops and fruits include:

| Crops/Fruits | Output per man-day (Kilograms) |
|--------------|--------------------------------|
| French Bean | 94 |
| Mango | 60 |
| Tomato | 57 |
| Durian | 49 |
| Chilli | 41 |

Farm level productivity has improved due to the emphasis towards a wider application of the latest farm technologies and the expending use of biotechnology. Productivity also improved due to large scale commercial farming, the production of high quality and value added products, wider application of ICT, and the development of agripreneurial skills through the various incubation programmes on offer.

The Outlook for Productivity in the Agriculture Sector



The sector is anticipated to record a productivity growth of 3.8% in 2008 supported by the current favourable performance of the export-oriented commodity industries. This is further supported by the implementation of High Impact Projects (HIP) in the newly launched economic regions and the establishment of more Permanent Food Production Parks (PFPP), Aquaculture Industrial Zones (AIZ) and Target Area Concentration (TAC) to expedite the domestic food production programmes.

The pace of R&D will be further intensified and more market-driven through collaboration with private sector-led R&D centres to promote world-class agricultural technology capable of boosting the efficiency, productivity and quality of agricultural products. Biotechnology development will be stepped up to produce quality planting materials and other areas of biotechnology development including food, agro-biotechnology and biopharmaceuticals such as antibodies and vaccines, and bioagnostics. Other products and areas which can be commercialised through biotechnology include culture cell, biodiesel, pharmaceuticals, nutraceuticals, herbal products and supplements for livestock.

A three year National Agricultural Production Plan will be implemented to look into new methods of increasing production in the shortest possible time taking into consideration both land and soil suitability. Besides finding new ways of increasing output, the National Agriculture Production Plan will also examine other new methods of reducing agricultural inputs especially fertilisers and chemicals. This will mean encouraging farmers to produce their own compost fertilisers to reduce dependency on imported chemical fertilisers.

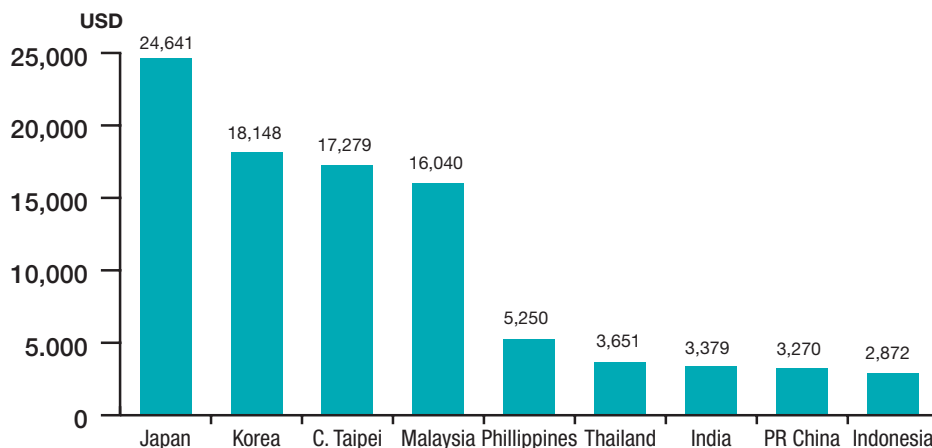




International Agricultural Productivity Comparison

The productivity of Malaysian agricultural workers in 2006 increased to USD16,040 compare with the USD10,594 in 2005, placing them ahead of counterparts in the Philippines (USD5,250), (USD3,651), India (USD3,379), PR China (USD3,270) and Indonesia (USD2,872). This was attributed to higher commodity prices especially oil palm and rubber resulting in higher farm income. Similarly, advanced countries such as Japan, Korea and Chinese Taipei were able to record higher productivity due to the adoption of both intensive cropping and hydroponic farming systems to optimise the land usage in these countries. Moving forward, it is anticipated that the productivity of Malaysian agricultural workers will improve further with the establishment of new economic development corridors which will provide the impetus for agricultural development.

International Productivity Comparison for the Selected Asian Countries, 2006



Source: World Competitiveness Yearbook, 2007

The Outlook for Productivity in the Services Sector

The services sector is the major contributor to the economy, contributing 53% to GDP in 2007. In the same year, output growth in the sector strengthened to 9.7% compared to 6.8% in 2006. This was mainly supported by strong domestic consumption, expansion in finance, insurance activities and the intensification of business and tourism activities.

The services sector registered a productivity growth of 5% to a level of RM54,229 in 2007 from RM51,653 in 2006. The growth was mainly driven by improved efficiency and higher ICT usage.

Moving forward, productivity of the services sector is expected to improve further. Growth in the trade sub-sector will be driven by strategies to boost retail spending, retail activities, advertising and promotional campaigns that had been identified in promoting retail offerings to foreign tourists in the Visit Malaysia Year 2007 (extended to 31 August 2008) campaign. The tourism industry is expected to maintain its performance in 2008. Continuous promotional efforts from both the public and private sectors to make Malaysia a prime tourist destination would further enhance the industry growth. The tourism sector on the whole is targeting to achieve 21.5 million tourist arrivals and RM49 billion in revenue in 2008.

Tourism receipts is expected to contribute more than 10% to the total sales value of the retail industry. Supporting facilities such as transportation would be provided to foreign tourists from airports and hotels to the various shopping destinations in major Malaysian cities. In addition, Government incentives will be introduced to stimulate consumer spending.

The transport sub-sector is expected to experience further productivity growth resulting from capacity expansion in transport infrastructure, better transport services through enhanced ICT applications, and an increase in investments by telecommunication service providers.

While the ICT industry is on target to experience productivity growth, however, there will be a slight slow down in ICT spending in 2008 due to increased competition from vendors in the marketplace. Furthermore, the recession in the US and rising oil prices will also affect ICT spending in Malaysia. Continuous efforts to promote Malaysia as an ICT hub and the growing importance of Shared Services and Outsourcing (SSO) are among the factors that can increase the efficiency and competitiveness of the sector. The SSO industry is expected to continue this strong growth, helping create job opportunities and more knowledge workers in the ICT industry. Apart from outsourcing services, emerging technologies like mobile number portability, metro Ethernet and web 2.0 are also expected to drive the ICT market in Malaysia.

Outlook for SMEs

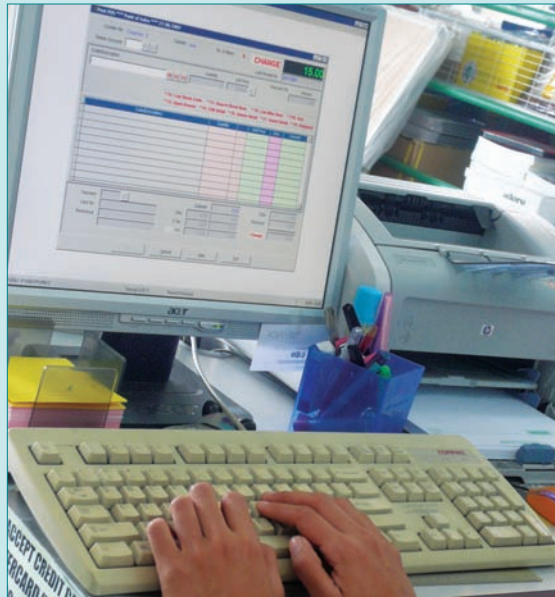
To compete successfully in the domestic and global markets, SMEs are encouraged to capitalise on outward investment opportunities, adopt best business practices and be more resilient in the face of greater competition. SMEs can venture into the identified new sources of economic wealth. Among some of the new areas are Halal products and services, franchising and ICT.

Since human capital development is expected to further spur the development of business start-ups and increase the supply of skilled and knowledge workers, SMEs need to improve on capacity and capability by investing in appropriate new technologies and intensifying the ongoing training of human resources.

As SMEs assume an important role in the economic growth of the country, the Government has put in place various measures to enhance their efficiencies and competitiveness. Various programmes including incentives in the form of grants and soft loans are made available to encourage SME in the development of innovative products and to automate processes, in order to keep pace with global demand for high quality and competitively priced products and services.

Promoting Greater Efficiency through e-payments

With the rising significance of internet and telecommunications as important communication tools in the world of commerce, SMEs are urged to look at the cost benefits of utilising technology to make and receive payments electronically. Electronic payment (e-payment) which provides the speed and convenience of making payments from any place at any time, will offer SMEs welcome respite in the current economic climate. Adopting e-payment solutions will enable SMEs to transact in the domestic and global markets more efficiently. The lower cost of doing business will contribute towards enhancing the overall competitiveness of SMEs and increase opportunities for greater business growth.



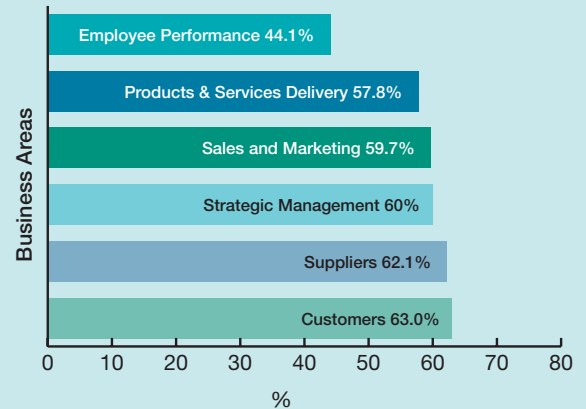
The Impact of ICT Implementation

SMEs can benefit either as producers of ICT or as users of ICT to increase their productivity, improve communications and attract new clients. ICT adoption can be a costly exercise, therefore SMEs need to clearly identify at the outset, what is essential to improve their productivity.

The most basic ICT tool is having communication capabilities through fixed lines or mobile phones. At the next level up, SMEs may consider investing in personal computers with basic software for simple information processing needs such as word processing to compile invoices for example, and to keep accounts on track. Internet access enables SMEs to have advanced communication capabilities such as e-mail, web browsing and developing websites. SMEs in manufacturing can benefit from more advanced ICT tools such as Enterprise Resource Planning (ERP) or inventory management.

Ultimately, the adoption and application of advanced technologies including ICT contribute towards the creation of competitive businesses. A study on the “Impact of ICT Implementation among SMEs” was carried out in 2007 highlighting six areas of business that have been profoundly impacted by the implementation of ICT.

Impact of ICT Implementation According to Business Areas



The study revealed that the greatest impact resulting from the implementation of ICT is in the area of building and managing the relationship between SMEs and their clientele base. The resultant increase in customer satisfaction and loyalty can only serve to have a positive impact on business. ICT implementation also led to improved efficiency in dealings with suppliers which produced an improved knock-on effect on products and services. The study also indicated that ICT assisted in the decision making process which resulted in better financial control and more efficient back-end and front-end functions, thus improving business process flow.

Other benefits cited were greater access to new markets leading to improved company branding, corporate image, prompt delivery of products and increased accessibility by end-users. Better utilisation of ICT also increased employees productivity and improved channels for communication within the company.

Casting a Wider Net - Growing Use of the Internet

The Internet offers benefits for a wide range of business processes at inter-firm level. It has great potential for reducing transactional cost and increasing the speed and reliability of business transactions. Internet utilisation enables businesses to respond faster to customers and produce better quality products. The utilisation of the Internet in Malaysia is on the rise with a 9.4% Internet penetration growth rate per 1000 citizens in 2007 with more than 50% people in Malaysia now using the Internet. With higher growth in the number of users, Malaysia is expected to be on par with Korea, Japan, Singapore and Chinese Taipei.

| Country | Internet Users per 1000 | | Growth World | Inhabitants (%) Rankings 2007 (2006) |
|-----------------|-------------------------|---------------|--------------|--------------------------------------|
| | 2007 | 2006 | | |
| Korea | 721.15 | 702.28 | 2.69 | 6 (6) |
| Japan | 711.18 | 676.62 | 5.10 | 8 (7) |
| Singapore | 662.99 | 619.29 | 7.06 | 15 (17) |
| C. Taipei | 598.26 | 580.10 | 3.13 | 22 (20) |
| MALAYSIA | 518.8 | 474.26 | 9.39 | 30 (32) |
| Thailand | 140.56 | 127.20 | 10.50 | 49 (53) |
| PR China | 103.59 | 84.44 | 22.67 | 52 (57) |
| India | 161.70 | 46.80 | 31.83 | 55 (60) |

Source: World Competitiveness Year Book 2007