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# CHALLENGES FOR THE INTERNATIONALIZATION OF SMES AND THE ROLE OF GOVERNMENT: THE CASE OF MALAYSIA


## ABSTRACT

SMEs presence is significant nowadays to most economies, particularly those from emerging countries. The internationalization of these firms is no longer an option; it is indeed necessary for them to follow the wave of globalization. Despite of their constraints, Malaysian SMEs are struggling to expand into the international market and compete internationally to sustain their foothold in the country. Various factors have forced SMEs in Malaysia to engage internationally, however the ventures are arduous to be accomplished independently. As a result, the Malaysian government has initiated various efforts in supporting them to stand in the international arena. Many agencies have been established and numerous programs have been developed to encourage SMEs internationalization. This study aims to unfold the challenges faced by SMEs from emerging countries in expanding internationally by examining the business environment in the country. The study finds that, despite various supports offered by the government, Malaysian SMEs continue to struggle in the global market due various factors including market knowledge, technological and skills capabilities, and products quality.


*Key words: small and medium enterprises (SMEs), internationalization, emerging countries, government role*

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# INTRODUCTION

Small and medium enterprises (SMEs) are nowadays becoming increasingly significant in the process of exporting and industrialization in the emerging economies. SMEs have now grown to be the largest cluster of industrial elements in most emerging countries, and have made a significant contribution to manufacturing productivity and employment in these countries. The considerable involvement of SMEs can be seen in income growth, entrepreneurial training, creation of technological capabilities, greater flexibility to changing market circumstances, job creation and lower wage inequality, dispersion of industry away from urban areas, and regional development (Katrak and Strange, 2002; Weeks, 2002). This is a remarkable achievement considering the natural drawbacks of SMEs due to their size and lack of industrial experience. SMEs also have the chance to be dominant drivers of export growth and manufacturing advances in the emerging economies. The evidence suggests that SMEs actively participate in the export efforts of emerging countries, but their contribution to exports varies between countries (Nadvi, 1999; Wignaraja and O'Neil, 1999). A great deal of this activity, however, is not officially recorded as it is a type of indirect exporting through sub-contracting for large exporters. Many SMEs also export to international markets through marketing relationships with foreign buyers of their output. A few SMEs have progressed even further into overseas markets by investing in the costly development of their own brands. Thus, with improvements in price, quality and delivery, SMEs could increasingly pose direct competitive threats to large firms in international markets. The term SME covers a diverse group of businesses in a developing economy, varying from a small shop making handicrafts to a sophisticated engineering firm selling in overseas markets (Fischer and Reuber, 2003). A number of different criteria can be used to distinguish between an SME and a large firm in an emerging economy. Three possible criteria are: the number of employees, the value of sales and the value of production equipment. The definition of SME may vary between countries, but, nonetheless, SMEs are generally defined by the number of their employees, because this figure is readily available. In Malaysia, the Small and Medium Industries Development Corporation (SMIDEC) defines small and medium enterprises according to annual sales turnover or number of full time employees. SMEs are divided between two sectors: manufacturing, manufacturing related services and agricultural industries; and services including Information and Communications Technology (ICT) and primary agriculture. However, it should be noted that during the past seven years the definition of an SME has changed three times. In 1999, an SME was defined as a Malaysian owned enterprise with net assets/ shareholders' funds of RM 10 million (usd 3.3 million), whilst prior to that the net assets/ shareholders' funds were limited to RM 2.5 million (USD 0.83 million) (Muhammad, Char, Yasoa, and Hassan, 2010).

SMEs in Southeast Asian economies have been recognized as a priority area, especially in the context of the Asia Pacific Economic Cooperation Forum (Harvie and Lee, 2002). The contribution of Asian SMEs to direct exports is as much as 35% (Hall, 2000). The SME sector in Malaysia continues to play a vital role in the country's industrialization program, and represents the backbone of industrial development in the country (Saleh and Ndubisi, 2006). 90% of local firms established in the manufacturing sector were SMEs in 2003 (SMIDEC, 2004). This number continues to rise whereby in 2007, 97% of Malaysian firms established in the manufacturing sector were SMEs, contributing 31% of total manufacturing output and 27% of total value added, and employing 32% of the total workforce (SMIDEC, 2009). The 2011 statistics indicated that SMEs constitute 99.2% of all business, contribute about 32% of GDP, and 59% of total employment. SMEs in Malaysia are distributed in all activity sectors, and play an increasing role in the local economy. The involvement of Malaysian SMEs in a diversified range of activities has strengthened the diversification of the overall economy. Malaysian SMEs have always been flexible and able to respond faster to opportunities in the global market and to exploit local opportunities to supply multinational firms that operate in the Southeast Asian region. Due to their increasing number and the nature of their operations, the role of SMEs in promoting endogenous sources of growth and strengthening the infrastructure for accelerated economic expansion and development in Malaysia has been recognized. Apart from their large numbers and their contribution to income generation through exporting, Malaysian SMEs are also known to provide new job opportunities, introduce innovations, stimulate competition, and supply giant companies such as multinational firms (Hashim and Wafa, 2002). Nonetheless, despite being major contributors to the country's economy, the involvement of Malaysian SMEs in the international market remains small. Exports by Malaysian SMEs were only 26% of their total output, which is much lower than in neighboring countries like Taiwan, Hong Kong, and the Philippines (SMIDEC, 2002). The largest concentrations of SMEs are in the textiles and apparel, food and beverages, metals and metal products and wood and wood products sectors.

Conceding to the significant of SMEs to the economy, the Malaysian government has been committed to and concerned in, their development since the early 1970s. The New Economic Policy was introduced in 1971, which aimed to improve people's welfare and to restructure ethnic economic imbalances. In 1996 a specialized agency, the Small and Medium Industries Development Corporation (SMIDEC), was established to spur on the development of SMEs by providing infrastructure facilities, financial assistance, advisory services, market access and other support programs. The aim was to develop capable and resilient Malaysian SMEs which were competitive in the global market. Following on from that, the National SME Development Council (NSDC) was established in 2004 as the highest policy-making body, to formulate strategies for SME development across all economic sectors, to coordinate the tasks of the relevant Ministries and Agencies, to encourage partnership with the private sector, and to ensure the effective implementation of the overall SME development programs in the country. The government's proactive efforts continued when the Small and Medium Enterprise Corporation Malaysia (SME Corp. Malaysia) was established in 2007, and this is now the central point of reference for information and advisory services for all SMEs in Malaysia. The support for SMEs in terms of government policies is obvious from the Second Industrial Master Plan (IMP2), which ended in 2005, and continues in the Third Industrial Master Plan (IMP3), which applies from 2006 to 2020. Under this master plan, the government has executed various policies and strategies to enhance the growth of the manufacturing sector through the whole value chain, and to promote cluster-based industrial development.

Though the potential to grow globally remains strong, there are major obstacles that SMEs have encountered which have slowed their internationalization process. Most of the studies on SMEs from developing countries focus on the challenges that SMEs face locally due to their size and capacity, whereas studies on the internationalization of SMEs are rather limited. Consequently not much is known about the internationalization of SMEs, particularly those from emerging countries like Malaysia, and therefore this paper aspires to set out some of the issues encountered by SMEs from emerging countries in the internationalization process. For instance, why is the involvement of Malaysian SMEs in the international market still low relative to that of SMEs from neighboring countries? It is curious that, despite the intense commitment of the government towards SMEs, the internationalization rate of SMEs remains low. It is also interesting to note which factors may contribute to the slow rate, when government efforts are intense in the development of SMEs. Besides that, it is important to identify the weaknesses in the government policies and incentives that dissuade SMEs from moving into international markets. Hence, this paper endeavors to shed some light on the challenges encountered by Malaysian SMEs in selling their products and services abroad. The paper is also intended to emphasize the role of the government, through its policies and incentives provided to SMEs, in relation to internationalization. Finally, this paper seeks to identify the major flaws in the government efforts which hinder the internationalization of SMEs. The first part of the paper will highlight the internationalization concepts and theories related to SMEs. Then the description continues on challenges of internationalization and role of government. Following that, a methodology and findings of this study are presented. Finally, the paper resumes with the discussion and conclusion of the study.

## INTERNATIONALIZATION OF SMEs AND RELATED THEORIES

A considerable growth of SMEs in exporting and international markets characterizes an international involvement for these firms. The global market provides new business opportunities for innovation, and new export markets through both upstream and downstream activities with large firms and between SMEs themselves. SMEs have played a central role in developing the private sector and integrating into the global economy as an efficient way to alleviate poverty in developing countries (Raynard and Forstater, 2002). To participate effectively in global markets, SMEs are required to have and maintain significant capabilities in different areas ranging over the industry value chain, including production, design, distribution, branding, and marketing (Abonyi, 2003). The internationalization of SMEs has expanded due to technological development, the deregulation of markets, the liberalization of world trade and the emergence of regional economic cooperation agreements. The advances in telecommunication and technologies have opened new perspectives for SMEs to become involved in the global market through the reduction of costs and risks. This circumstance enables SMEs to learn from their global ventures and to exploit opportunities in foreign markets further. The successful transformation and growth of the economy require SMEs to utilize existing resources and leverage for new market opportunities. SMEs that engage in the global market are at advantage on both platforms – internationally and domestically. Internationally, SMEs that operate in overseas markets can gain new experience and incorporate this into their local operations, thus leading them to strengthen their competitiveness and global presence (Lages and Montgomery, 2004). Domestically, internationalization creates social prosperity, helps national industries to improve productivity, engenders foreign exchange, supports socio-economic development, diminishes the national deficit and enhances employment opportunities.

According to the Uppsala Model, internationalization is an outward movement in a firm's international operations (Johanson and Wiedersheim, 1975). Research on internationalization tends to focus on large manufacturing firms. Many theories have tried to explain the phenomenon of internationalization through both economic and behavioral approaches. Coviello and McAuley (1999) acknowledge that none of the theories or models can fully capture the actual internationalization of SMEs, which means that an integration of these theories and models is recommended for understanding the process. It has been argued that the internationalization process is incremental and gradual, due to a lack of knowledge about foreign markets and the tendency to avoid uncertainty (Johanson and Vahlne, 1977; Johanson and Wiedersheim, 1975). Market knowledge is acquired primarily through experience obtained from current business activities in the market. Lack of knowledge and resources is considered to be the most important constraint on internationalization. Knowledge is considered as a resource and it is assumed that the better the knowledge about a market, the stronger the commitment to the market. In the Uppsala Model, learning is the key factor in identifying business opportunities in foreign markets.

Different terms explaining the phenomenon of the internationalization of SMEs, which is becoming increasingly common, are born-global firms, International New Ventures (INV), Instant Internationals, Infant Multinationals or High Technology Start-Ups. According to Hashai and Almor (2002), "Born global SMEs are small, entrepreneurial enterprises incorporating characteristics of multinational enterprises (MNEs) in terms of target markets and international dispersion of value adding activities and they appear to have a number of unique features and are inherently paradoxical." Many firms do not develop in incremental stages in their international activities. They often start international activities right from their birth, entering very distant markets right away, entering multiple countries at once, or even forming joint ventures without prior experience. Two major factors that explain the born-global phenomenon are: the management's commitment to internationalization, and the firm's ability to standardize production, marketing, and other functions in a global market instead of customizing them (McKinsey and Co., 1993). Ganitsky (1989) refers to born-global firms as 'innate exporters,' as opposed to 'adoptive exporters'; innate exporters tend to be more flexible and often have a lack of experience and resources. Looking into the characteristics of "High Technology Start-Ups," Jolly, Alahuhta, and Jeannet (1992) found that their founders were people from different countries and that they followed strategies focusing on international niche markets. Thus, due to their high tech products, these firms may have to be international right from the beginning. Oviatt and McDougall (1994) refer to this type of firm as an "International New Venture" (INV), and define it as "a firm that right from its birth seeks a competitive advantage by using resources from several countries and selling its products in several countries." Bell (1995) discovered that between 30% and 50% of small computer software firms in Ireland, Norway, and Finland did not follow the stages suggested in the traditional models. Vítor and Dominguihos (2001) found that born-global firms are not just found in technology-intensive sectors but other sectors as well. Entrepreneurs' leadership desire and a need for short-term profits are the major drivers in the formation of Vietnamese born-global firms (Thai and Chong, 2008).

## INTERNATIONALIZATION CHALLENGES AND THE ROLE OF GOVERNMENT

SMEs often suffer from their limited size and resources, and thus end up encountering numerous challenges in their efforts to enter the global market (Coviello and McAuley, 1999). SMEs also face constraints on their knowledge and experience at the international level, exposing them to various threats such as the presence of larger firms, stronger competition, higher barriers to entry, and power asymmetries in value chains. Johanson and Vahlne (1977, 1990) argue that SMEs from emerging and developing countries faced difficulties in internationalizing and establishing a foothold in the international market due to lack of market and product knowledge and cultural differences. The borderless world exposes SMEs to many challenges that affect their businesses both domestically and internationally. Etemad (1999) argued that "entrepreneurs and emerging businesses must learn about global business to thrive alongside larger firms already in the international marketplace."

The concept of the business environment is a broad notion that includes various dimensions. Gnyawali and Fogel (1994) identified them as (1) government policies and procedures, (2) socio-economic conditions, (3) entrepreneurial and business skills, (4) financial support, and (5) other support. The area with the greatest potential lies in studies that seek to explore in more detail the ways in which environmental factors influence entrepreneurship internationally. In many developing countries, central and local government plays an active role in the economy, and firms tend to be attuned to government priorities and preferences. Government support provides firms from developing countries with privileged access to certain inputs, preferential financing, subsidies and other support. SMEs gain similar attention from the government when they act as boosters to the country's economic growth. Support from the local government is provided for SMEs not only in developing countries but also in developed countries, as internationalization is recognized as a significant yet formidable and exorbitant process. The whole policy and business environment in developing countries is possibly the most important influence on private sector investment and exporting behavior including building export capabilities in SMEs (Badrinath et al., 1997; Levy, 1993; Meier and Pilgrim, 1994). Factors related to the policy and business environment can be classified into two main sections; first, the application of government policies, regulations and procedures relating to macroeconomic conditions, international trade, domestic competition, taxes, bureaucratic procedures and labor; second, the institutions and other aspects of the business environment relating to finance, infrastructure, market conditions, law and crime (Wignaraja, 2003).

Government policies in supporting the development of SMEs differ between developed and developing countries. This is often due to differences in business contexts, culture and the level of industrialization. SMEs in emerging/developing countries in Southeast Asia obtain support from their local governments in the form of micro finance, interventions to increase private sector training, technology development, and market information (Batra and Mahmood, 2003). Indonesia, Thailand, and Malaysia, in a similar way to China, gained from the policies they implemented, from networking relationships, from cluster linkage to markets, and from a new support infrastructure (Brimble, Oldfield, and Monsakul, 2002; Harvie, 2001, 2002; Tambunan, 2005). Dallago and McIntyre (2003) affirm that SMEs are not themselves sufficient for growth without the appropriate development of institutions and support structures. The supportive actions may be in the form of incentives, tax breaks, subsidies, export training, or trade barriers. Smallbone (2004) also asserts that businesses need to have conditions such as: a legal infrastructure that is appropriate to market conditions; a legal framework that facilitates the development of entrepreneurship; and commodity, capital and labor markets. Institutions, including regulatory and tax authorities, licensing and registration offices, and private sector institutions, such as banks, accountancy firms, other professional bodies and Chambers of Commerce, must provide business support to SMEs (SMIDEC, 2004). Changes in the international business environment make SMEs fragile, so they need to be supported, guided and nurtured by their governments for a certain time until they develop their own capabilities and strengthen their competitiveness, allowing them to face and compete with foreign firms primarily from developed countries.

## METHODOLOGY

This study adopts a qualitative approach as its emphasis is on meanings and processes that cannot be measured in terms of quantity, frequency, intensity or amount. The qualitative approach allows for a deeper understanding of the phenomena that are being studied. Therefore, the qualitative approach is more consistent with the purpose of this study. In topics like internationalization, qualitative research is useful in investigating the meanings and interpretations that people (here, experienced entrepreneurs) give to events they have experienced, and is appropriate for understanding human phenomena like the orientation of entrepreneurs and their actions and behavior. Only a few statistics are used in the measurement of certain factors and the depiction of the involvement of SMEs in the global market, but most of the information and data are qualitative and serve to describe and explain the overall environment, and to seek the driving forces that lead SMEs towards international operations.

A wide range of documents was used in this study to augment and corroborate evidence from external sources offering the necessary information about the motives of SMEs in Malaysia, and their practices in terms of international business. Two sets of documents were used. The first set includes data provided by the relevant governmental bodies such as the NSDC, Bank Negara Malaysia (BNM), SMIDEC, the Export-Import Bank of Malaysia (EXIM Bank), SME Bank, and MATRADE (which provides general information and statistics about the sector of SMEs in Malaysia and incentives, strategies and policies designed to develop the SME sector and prepare it for internationalization). In addition, the report of United Nations Development Program (2007) was used, which provided information on the challenges of globalization for Malaysian SMEs, their policy and institutional framework, and the practices adopted to promote their growth. The second set of documents contains the formal studies that have been conducted by scholars to investigate the behavior of SMEs in Malaysia in relation to their internationalization. These articles are published by local, regional, and world journals and treat a variety of aspects related to the topic of this study, including the adoption of e-commerce and government incentives. The population involved small and medium sized firms, but the sample was not limited to any particular sector of SMEs, in fact it covered the entire SME sector in Malaysia, including all firms both small and medium which are registered with the various agencies and institutions from which data was collected, such as SMIDEC, the NSDC and SME Bank.

Data was analyzed to identify, examine, compare and interpret themes and patterns. The analysis started after the collection of all the necessary data. Before the analysis, the data were classified and stored in different files as soon as they had been collected, in order to keep them undamaged. They were also reviewed regularly as new connections and questions emerged. The maximum amount of relevant information and statistics were retrieved during the analysis. The analysis was based on an extensive reading of all the available data in order to identify the most relevant information and to compare this with information gathered from other sources, because data was collected from different sources. This comparison was intended to allow us to select only reliable information.

## FINDINGS AND DISCUSSION

### Internationalization challenges for Malaysian SMEs

SME firms in Malaysia are struggling with various challenges in their process of internationalization, and these impede them from achieving economies of scale and competing in the international market (Saleh and Ndubisi, 2006). Deciding to enter new markets represents one of the most challenging options for SMEs. Among the major obstacles that Malaysian SMEs encountered include accessibility of finance, lack of skilled human capital, business competition, accessibility of technology and innovation infrastructure, and non-conducive government policies (Saleh, Caputi, and Harvey, 2008). Ting (2004) argued that Malaysian SMEs could be wiped out if they did not improve their competitiveness in the near future. Based on assorted previous findings, this study summarizes the internationalization challenges faced by Malaysian SMEs, and groups them into seven groups which include: lack of market knowledge, limited access to financial support, lack of infrastructure, technology and human capital, business competition and government policies.

1) *Market knowledge* - One of the major barriers to successful foreign expansion by SMEs is a lack of international experience because they are new ventures. SMEs also lack information on overseas markets and foreign market access which worsens their internationalization process. On top of that, they were also lack of information on potential markets, thus making them risk adverse. SMEs moreover face a lack of knowledge on legal matters, because no agencies can advise them on the specific legal issues of going abroad such as international rules and regulations (Baird, Lyles, and Orris, 1994; Teoh and Chong, 2008; Ting, 2004; United Nations Development Program, 2007; Viczrany, 2001).

2) *Financial constraints* - Malaysian SMEs were lack of access to loans or other forms of financial assistance. There is also a shortage of internal funds for setting up business channels abroad. In addition, venture funds for initial financing are still at an infant stage (Baird et al., 1994; Saleh et al., 2008; Saleh and Ndubisi, 2006; Ting, 2004; United Nations Development Program, 2007; UPS, 2005; World Bank, 2005).

3) *Lack of infrastructure* - In addition, SMEs were lack of focus on addressing domestic limitations and enhancing their capacities and capabilities in areas such as infrastructure. Many Malaysian SMEs occupy land sites which have not been approved for industrial use. They also face soaring infrastructure costs (Saleh et al., 2008; United Nations Development Program, 2007; Vicziany, 2001; World Bank, 2005).

4) *Lack of technology and innovation* - SMEs are unable to adopt the latest technology or, if they do, they adopt a low level of technology, have a low level of technological capability and ICT penetration, and have low levels of research and development (R&D). Clusters have been created, but they are judged not to be performing as they were expected to do, and are becoming less important because the process of technology transfer is very slow. Therefore, SMEs were incapable of being in the mainstream of industrial development. Most local SMEs in Malaysia had not installed an Information Technology (IT) infrastructure, such as a Local Area Network, and less than 20 per cent of SMEs had access to the Internet. Therefore, the implementation of ICT among SMEs in Malaysia is still at a basic level, where computers are only used for simple accounting and word processing. Use of sophisticated programs and applications such as Supply Chain Management (SCM), Enterprise Resource Planning (ERP) and Customer Relationship Management (CRM) is insignificant because their advantages have not yet been appreciated. The high cost of installing hardware and software programs, mixed with

problems of system maintenance, are impediments to the adoption of an ICT infrastructure. The application of E-commerce is not at the level required for the internationalization of SMEs, because they have confidence in the more familiar regional and international trade shows rather than the B2B portals that offer a huge potential for marketing and supplying outside Malaysia. (Saleh and Ndubisi, 2006; Ting, 2004; United Nations Development Program, 2007; UPS, 2005).

5) *Human capital* - SMEs were facing a major problem in managing their human capital. The human resource constraints include the limited skills of workers, a shortage of skilled and talented workers, restricted capacity for technology management and knowledge acquisition. As a result, SMEs were not able to upgrade the quality of their production for other countries and this affects the quality of production as well as efficiency and productivity. SMEs also face difficulties in managing workers who are employed abroad, and maintaining their skills for a new business environment that are constantly deficient (Baird et al., 1994; Saleh et al., 2008; Saleh and Ndubisi, 2006; Ting, 2004; UPS, 2005; Viczrany, 2001; World Bank, 2005).

6) *Business competition* - SMEs also were lack of experience in international business practice, and have a substantial orientation towards domestic markets rather than the global market. SMEs face intensifying global competition from other developing countries, primarily from the members of the Association of South East Asian Nations (ASEAN) Free Trade Agreement (AFTA). SMEs also face competitive pressures from larger regional economies such as China, India and Indonesia that have advantages of scale in terms of market size and cost. In addition to this, SMEs have limited capabilities to cope with market liberalization globally. Liberalization has harmed local SMEs as they have to compete with cheaper, more innovative incoming foreign products and services, and compete for resources and capital (Abu Bakar, Mad, and Abdul Latif, 2006; Saleh et al., 2008; Saleh and Ndubisi, 2006; SME Corp, 2010; Ting, 2004; World Bank, 2005).

7) *Government policies* - Another major challenge related to public policy is Malaysia's bilateral FTAs and the ASEAN Free Trade Agreement (AFTA) which have resulted in an increasing intensification of competition. Furthermore, a high level of bureaucracy in government agencies contributes to the challenges. SMEs also face a problem from the government where there is a lack of awareness of all the institutional actions designed to develop SMEs. There is also a lack of awareness of government incentives to support the adoption of new technology. The ways of advertising these incentives are faulty or lack coverage. Despite various programs having been developed to support the

internationalization of SMEs, several flaws were found that obstruct and delay the speed of internationalization of Malaysian SMEs. It was discovered that the framework developed for the development of SMEs was not very comprehensive. The definitions used to categorize SMEs are still vague and inconsistent especially at the operational level, thus creating confusion among firms. There were also too many agencies or channels involved, and most of them are not linked to each other and are not coordinated. This causes a lack of transparency for the firms, and it requires enormous effort to verify certain required information. The data and information on Malaysian SMEs are inadequate and are not updated frequently. Technical assistance, advisory services and other incentives given by the government and its agencies are not fully capitalized (Saleh et al., 2008; SMIDEC, 2002; United Nations Development Program, 2007; UPS, 2005; Viczrany, 2001; World Bank, 2005).

The most recent study conducted by SME Corp (2010) on SMEs indicates that there were several key new issues faced by SMEs in 2010. Table 1 below summarizes the types of issues and their magnitude. The three main sectors that were badly affected are manufacturing, services and agriculture. Manufacturing was greatly affected by the rising of raw material costs, overhead costs and cash flow constraints. The agriculture and services sectors had similar issues.

**Table 1: Types of Key Issues by SMEs in 2010**

| | Key issues | Frequency in percentage |
|---|---|---|
| 1 | Increase in cost of raw materials | 54.2% |
| 2 | Rising overhead costs | 51.8% |
| 3 | Cash flow problems | 37.0% |
| 4 | Delay in payment collection | 35.3% |
| 5 | Lack of external financing | 33.8% |
| 6 | Reduction in demand | 31.4% |
| 7 | Labor quality and skills issue | 22.8% |
| 8 | Labor supply issue | 21.9% |
| 9 | Difficulty of coping with increase in demand | 17.5% |
| 10 | Ringgit fluctuation | 14.9% |

Source: SME Corp (2010)

## The role of government in supporting the internationalization of SMEs

In Malaysia, supportive governmental policies are imperative and significant for SME growth and internationalization. The role of government is to encourage SMEs to move to higher levels and gain competitive advantage in the global environment (Samad, 2007). A variety of incentives, programs and policies have been implemented by the government to strengthen SMEs and to enable them to deal with global competition. These include:

1) *Long-term Strategic Planning* - Long term policies and institutional frameworks have been established to address the needs of SMEs. For the 8th Malaysia Plan (2001–2005), the emphasis was on the development of SMEs in the manufacturing sector. The NSDC was also established in 2004 to ensure that SME development plans were on the right path. It works closely with other agencies, ministries, banks and financial institutions, providing support to SMEs and monitoring the outcomes. The 9th Malaysia Plan (2006–2010) and the Third Industrial Master Plan (2006–2015) continue to outline key strategies for SME development. They are aimed at enhancing their capabilities to become regional and global entities and to compete for access to global supply and production chains by focusing to increase their access to capital, access to business services, improve the general business environment and enhance the application of ICT, building capacity and enhancing productivity. Funding was made available through agencies like the Malaysia External Trade Development Corporation (MATRADE), the Malaysia Technology Development Corporation (MTDC), SMIDEC and the Standards and Industrial Research Institute of Malaysia (SIRIM) Limited.

2) *Export Agent* - MATRADE, a government agency under the Ministry of International Trade and Industry (MITI), plays a vital role as a facilitator for the internationalization of Malaysian SMEs. Various export initiatives have been launched to facilitate the engagement of SME firms in export activities. MATRADE undertakes efforts to develop markets overseas for products and services for both SMEs and other large companies. The Market Development Grant (MDG) scheme has been established to assist SMEs in undertaking activities for the development of export markets. A grant can be used for various participation internationally such as for international trade fairs, investment and trade missions, market negotiations to access foreign markets, promotional activities in export markets, the initial cost of establishing an overseas office, outsourcing, research on the market and monitoring the projects and contracts abroad, international tenders, and conducting export market research abroad (MATRADE, 2009a). Besides MDG, there is also a Women Exporters Development Program (WEDP) to assist

enterprises owned by women who have limited experience in exporting, or want to export for the first time. This scheme is for enterprise in which a woman owns at least 51% of the equity and is the biggest shareholder (MATRADE, 2009a). MATRADE also offers export training programs for new Malaysian exporters to enhance their awareness about export opportunities and the development of their export marketing skills which include branding, country briefings, import regulations, international product and environmental standards, trade financing, market updates, market requirements and skills in international marketing and e-commerce (MATRADE, 2009b). MATRADE also organizes seminars and workshops, for instance a Trade Advisory Help Desk to serve as the first point of contact for business visitors who have general enquiries about MATRADE's services and programs from the business community both locally and overseas. Besides that, MATRADE also provides publishing directories and handbooks, advisory services and dissemination of information via online news and websites, as well as feedback on export related programs issues and activities.

3) *Financial Agent* - Apart from policies and management support for internationalization, the Malaysian government also provides financial support to SME firms. Multi-Currency Trade Financing (MCTF) has been developed by EXIM Bank to facilitate the financial transactions of SMEs. This involved EXIM Bank and other local commercial and Islamic banks so that SME exporters can be financed with working capital from banks without furnishing any collateral; all transactions using this facility must involve an Irrevocable Letter of Credit issued for the overseas buyers. The objective is to encourage the export of goods and services by SMEs abroad, in particular to the ASEAN, OIC, and G-15 countries, and to enable them to access the banks' pre and post-shipment working capital trade financing without any collateral (EXIM Bank, 2006). Multiple facilities also are offered by EXIM Bank such as 1) Supplier Credit, which is a type of financing that enables exporters to execute orders in hand, 2) Overseas Contract Financing (OCF) and an Export Services Facility, 3) Overseas Project Financing (OPF), 4) Buyer Credit, which consist of loans granted to foreign buyers of Malaysian goods and services, 5) the Malaysia Kitchen Financing Facility, designed to finance the establishment of Malaysian restaurants overseas, and 6) MCTF. In addition there are other facilities that are designed to protect commercial banks who finance the international activities of SMEs, and these indirectly benefit SMEs; they include the Indirect Export Financing Scheme

(IEFS), the EXIM Overseas Guarantee Facility (EOGF) and the IDB Co-Financing Facility (Exim Bank, 2006).

4) *Negotiator* - In its efforts to ensure fair competition and opportunities for SMEs exporters, the Malaysian government actively participates in trade negotiations and regional and bilateral trade agreements to reduce barriers. Therefore SMEs must ensure they comply with market requirements in terms of product quality, delivery schedules and pricing, to benefit as much as possible from this advantage. The SMIDEC Annual Showcase (SMIDEX) represents another way for SMEs to explore new market opportunities. At SMIDEX, SMEs are given an opportunity to exhibit their goods and to demonstrate their service capabilities to potential customers, and to exploit possible links and networking with MNCs and larger firms. This event, for instance, attracted 4,279 trade visitors, paved the way to 183 business-matching sessions between 50 SMEs and 37 MNCs and generated total sales of RM 3.1million (SMIDEC, 2008). The Malaysian government also has emphasized franchising as one of several strategies to promote a globally recognized Malaysian brand. The SMEs Annual Report 2006 reported the existence of 321 franchise systems in Malaysia, and out of these 124 is contracted by Malaysian SMEs with foreign franchisees, accounting for more than 3% of total retail sales (SMIDEC, 2008).

5) *Tax and Incentives* - To encourage publicly listed SMEs to expand and compete in the international market, stamp duty and real property gain tax (RPGT) exemptions are given on mergers and acquisitions undertaken by companies listed on the Malaysia Bourse (SMIDEC, 2009). A Malaysian-owned SME that acquires a foreign-owned company established abroad for the purpose of acquiring high technology for production within the country or of gaining new export markets for a local product will be granted a deduction equivalent to the acquisition costs for five years (SMIDEC, 2009).The government also has created a Brand Promotion Grant (BPG) in order to assist Malaysian companies both large and small. The BPG is assigned to the development and promotion, in the international market, of brand names owned by Malaysian companies for products and services originating in Malaysia. Products and services are easily replicable in the current environment of business, which poses a big challenge for SMEs who want to differentiate their products from their competitors in the global market. Advertising and promotions are vital elements of branding. SMEs, therefore, should work with agencies that can provide professional advice on how to develop, promote and manage their brands to ensure that the brands are well positioned in the market. The government has also

provided certain incentives and grants with the aim of creating Malaysian brands with quality, and differentiating Malaysia's products in the world market, thus enabling local exporters to avail themselves of various incentives and grants while also working towards reducing their cost of doing business. These include outsourcing inputs for business activities and seeking out lower cost inputs, increasing productivity and upgrading technology, business collaboration to enhance production, R&D and marketing, creation of a pro-business environment, continuous efforts to improve delivery systems and reduce the cost of doing business and enhancing conditions of market access through tariff negotiations under bilateral, regional and WTO arrangements. SMEs are encouraged to undertake outward investment in order to gain access to new export markets and become competitive suppliers abroad. SMEs also are expected to benefit from a wider sourcing for industrial inputs which eventually would create greater opportunities for collaboration and resource sharing.

6) *Regional cooperation* - SMIDEC's participation in many regional workshops, seminars and programs is beneficial and allows SMEs to learn methods and strategies that need to be implemented within the national SME sector, and to strengthen its competitiveness to exploit opportunities in the international market. Under regional cooperation various SME programs have been designed, such as SME Programs under ASEAN; SME Programs under APEC; the inaugural Asia-Europe Meetings (ASEM); and the Industrial Linkage Program (ILP) which creates linkages across industries in the manufacturing sector. SMEs, under the Industrial Linkage Program, are linked as suppliers to large companies and multinational corporations (MNCs) for both products and services. The Global Supplier Program (GSP) is a further extension of the ILP and provides an opportunity for SMEs to participate in the global supply chain and for their ICT and E-commerce development to keep pace with technological progress. Strong ICT capabilities are very important because firms all around the world are increasingly relying on internet-based business-to-business (B2B) as efficient portals to source intermediate inputs and services. SMIDEC, in collaboration with a private company from the United Kingdom (UK), initiated the 'Nurturing Globally Competitive SMEs through Innovation' program to meet the strategies of the Ninth Malaysia Plan. The Program aims to develop, nurture and coach Malaysian SMEs in the Information Technology sector to commercialize their products and services (MITI, 2007).

## Effectiveness of the government support for the SMEs

In recapitulating the holistic efforts initiated by the government, most of the programs developed have been oriented towards the building capacity and capability. 73% of the whole programs were to build capacity and capability while other programs were to enhance access to financing and to strengthen infrastructure. Table 2 indicates the number of programs and number of SMEs benefited from such programs as well as the expenses on such programs. The programs devoted to building capacities and capabilities can be classified into four major areas; entrepreneur development, human capital development, marketing and promotion, and product development.

**Table 2: SME Development Programs in 2010**

| Strategic thrusts | Number of programs | Number of SMEs benefited | RM(Million)/ USD(Million) |
|---|---|---|---|
| Strengthening enabling infrastructure | 23 | 6,672 | RM 179.8<br>USD 60 |
| Building capacity and capability | 165 | 338,134 | RM 717.8<br>USD 239 |
| Enhancing access to financing | 38 | 269,436 | RM 6, 256.1<br>USD 2,085 |

Source: SME Corp (2010)

Many SMEs have enjoyed and reap the benefits given by the government in various roles as discussed above. More than 286,000 SMEs have been assisted through 189 development programs initiated by the NSDC and involving a total expenditure of RM 4.9 billion (USD 1.6 billion). These programs provide business support services, entrepreneurship training, technical training, business premises and factories. A national microfinance program which was launched in October 2007 was taken up by 26,000 micro enterprises, with total micro financing of RM 271 million (USD 90 million). In 2008, RM 3.2 billion (USD 1.1 billion) was allocated for 198 key programs which benefit SMEs across all economic sectors, in the areas of enhancing the supporting infrastructure, building capacity and improving access to financing. Table 3 summarizes the percentage of SMEs that have benefited from the government programs.

**Table 3: Government Programs that Benefit SMEs**

| | Government programs | Frequency in percentage |
|---|---|---|
| 1 | Soft-loan financial assistance | 36.4% |
| 2 | Matching grant financial assistance | 36.0% |
| 3 | Training, seminars and workshops | 35.8% |
| 4 | Marketing and promotions by government | 23.1% |
| 5 | Government websites and TV programs | 21.6% |
| 6 | Tax benefits and tax exemptions | 21.3% |
| 7 | Business advisory services or one stop center | 21.3% |
| 8 | Government publications, pamphlets, brochures etc. | 19.1% |
| 9 | Pioneer status and investment tax allowance | 16.7% |
| 10 | Physical infrastructure and business premises from government | 16.1% |

Source: SME Corp (2010)

The results indicate that SMEs benefit most from soft-loan and matching grant financial assistance. Government support through its financial agencies, as discussed above, is shown to have a significant effect on SME ventures. The NSDC provides development programs and financial assistance to SMEs. The Central Bank of Malaysia also provides financial assistance, by implemented several measures to enhance access to financing by SMEs. There are 26 agencies, 2 ministries and 9 banking institutions involved in providing financial assistance to SMEs in the form of soft loans, grants, equity financing, venture capital, guarantee schemes and tax incentives. The records show that in 2007 the non-performing loan ratio declined to 9.1% from 11.1%, and a total of RM 63.2 billion in financing for more than 132,000 SMEs by banking institutions and development financial institutions was approved (Bank Negara Malaysia, 2008). Government support through its export agencies like MATRADE and its SME agencies such as SMIDEC and SME Corp have provided benefit to SMEs through their training, seminars, and workshops. As for marketing and promotion activity, the Ministry of Entrepreneurs and Co-operative Development (MECD) and MATRADE have organized several promotional programs locally and abroad for SME products and services. Such events offer a platform for SMEs to penetrate and widen their target market.

Government publications, pamphlets and brochures have been distributed by the government abroad through its agencies MITI, MIDA, MATRADE and others via international trade missions and other means. Government aid, in terms of tax and incentives, pioneer status, and investment tax allowances, has demonstrated that the government provides advantages to SMEs in certain ways. The findings indicate that the role of the government as negotiator and advisor has helped SMEs to improve their businesses. Government assistance is also shown to be useful in developing the physical infrastructure and business premises of SMEs. In terms of enhancing supporting infrastructures for SMEs, the government provides business premises, factories, business stalls and incubation centers. Two major infrastructure projects were the establishment of Halal Park and a center for the packaging, distribution and marketing of agriculture products (PUSPRO). These projects create opportunities for SMEs to market their products better and to lower their production costs.

The government is struggling to improve current programs and incentives to help SMEs to be more competitive. For instance, the NSDC recently agreed to provide tax incentives to encourage SMEs to upgrade their machinery and equipment and to adopt new technology, and implemented development programs to enhance the capabilities of SMEs and to reduce their operational costs. In order to counter rising operational costs that had caused financial difficulties, viable SMEs could seek financing from the SME Assistance Facility, with a total amount of RM 700 million (USD 233 million) having been made available by the Central Bank of Malaysia since August 2008.The Central Bank of Malaysia and other relevant agencies have provided avenues for SMEs to seek advice on matters pertaining to the better management of cash flows and rising costs. The Central Bank of Malaysia has set up a one-stop financial advisory for SMEs to know more about the available financial and non-financial programs provided by the government. Banking institutions play their role by setting up SME Units at banks to provide information on the various sources of financing available, to provide advisory services and to facilitate loan application processes. The Advisory Center of the SME Bank offers similar assistance, together with expert advice on marketing, business development, operations and customer services.

## CONCLUSIONS AND RECOMMENDATIONS

With the current trends of globalization, SMEs are facing a turbulent environment in which competition is intensifying whilst their size and other existing constraints remain the same. Malaysian SMEs are becoming significant in the nation's agenda because they contribute considerably to the economy, provide strong and underpinning economic growth in new industries, and strengthen existing industries for the country's future development. The development of diverse sectors of SMEs and globally competitive

SMEs is critical for the achievement of sustainable economic growth. Nonetheless, despite this significant participation, Malaysian SMEs have to deal with various challenges such as lack of financial capability, lack of market knowledge, lack of infrastructure, lack of technology and innovation, lack of human capital, business competition and government policies that hinder their prospects in the international market. The Malaysian government has spent millions of dollars and made numerous efforts to ensure the expansion and growth of SMEs locally and internationally. Various bodies and agencies have been created which focus especially on the specific development of every sector concerning SMEs. This indicates that Malaysia has a high commitment to development by strengthening these SME sectors and recognizing their great potential for economic growth and human development. This continuous effort is important in improving the competitiveness of SMEs and their development strategy towards the international market.

As the internationalization of SMEs is increasingly demanding nowadays, SMEs need to me more proactive and capitalize the government programs in order to internationalize and be more competitive. The escalating cost of conducting business recently requires SMEs to strengthen their management skills, financial capabilities and learning capacities, to improve their infrastructure, and to fully utilize the support given by the government. Hence, both policy makers and Malaysian SMEs should gear their efforts towards change, in order to overcome the challenges and increase their competitiveness in the global market. Incentives given by the government to SMEs for their internationalization should be effectively and efficiently exploited, and the quality of products must be elevated to conform to international standards and enhance market share. SMEs have to adopt innovative and cutting edge technologies, and should give priority to R&D in ameliorating product quality and work processes which may revive their competitive advantage. Governments, on the other hand, should continuously upgrading the environment so that it is conducive to the international growth and development of SMEs, by proactively seeking international business opportunities, strengthening legal institutions and administrative and financial establishments, and formulating appropriate policies.

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