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Strengths and Weaknesses among Malaysian SMEs: Financial Management Perspectives

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Abstract

In Malaysia, 97.3% of business establishments are comprised of small and medium enterprises (SMEs) which account for about 52.7% of total employment that is generated in the country. Malaysian government through the Ministry of International Trade and Industry (MITI) and its agencies works hard on assisting SMEs through various activities to promote exposures on prudent financial management. This paper aims to identify the financial strengths and weaknesses face by SMEs in helping those entities to plan appropriate financial management programme. Semi-structured interviews were conducted among thirty five SMEs that are willing to participate voluntarily. This study found that capital is the key elements in both strengths and weakness among SMEs. Running the business without any external capital (loan) reducing the financial risk of the business. It will be easier for the managers to make business decisions without any constraint as there is no limitation set by fund provider. The study also revealed capital insufficiency is the crucial problems among SMEs which might due to the difficulties to obtain external fund. Although the results should be taken with caution, nevertheless financial management is vital in order to face new business challenges as well as for the survival of the business in the future.

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1. Introduction

Small and medium enterprises (SMEs) play important roles in Malaysian economy. Report of Malaysia Economic Census 2011 showed that there were 645,136 SMEs operating in Malaysia, representing 97.3 per cent of total business establishments. Furthermore, SMEs employed about 3.7 million out of a total of 7.0 million workers amounting 52.7 per cent of total employment in the country. With a total share of gross output reached 28.5 per cent in year 2011 as compared to only 22.2 per cent in year 2000 it shows that the roles are getting significant.

A considerable amount of literature has been published on the management issues of SMEs. On the other hand only few studies were focusing on the financial management, especially in developing countries although it has been known that, financial management plays crucial function in business management. Report on case study conducted by Bank Negara Malaysia (2003) on SMEs, suggested that one of the key elements SMEs should adopt to survive for a long term, in a global environment is prudent financial management. It will ensure that all the available business resources are used efficiently and effectively to provide optimum return (SME Corporation Malaysia, 2011).

The aim of this paper is to identify the strengths and weaknesses face by Malaysian SMEs in term of financial management.

2. SMEs Definition in Malaysia

There is no solid meaning of SMEs as different countries are using different definition due to several demographic factors and characteristics including size, location, structure, age, number of employees, sales volume, ownership through innovation and technology (Zeinalnezhad et. al, 2011). Based on employees number and total turnover, Malaysia adopts slightly similar definition as being use by United Kingdom, United States of America, Japan, China and Korea (Norailis, 2013).

Previously Malaysian SMEs were defined as firms with sales turnover not exceeding RM25 million or employment not exceeding 150 workers for manufacturing and sales turnover not exceeding RM5 million or employment not exceeding 50 workers for services and other sectors. As the economy has change and the business trends are moving abroad. On 11th July 2013, Malaysian Prime Minister Datuk Seri Najib Tun Razak announced the new criteria of SMEs which will be effective on 1st January 2014. Table 1 shows the new classification of SMEs.

Table 1. New classification of SMEs

SMEs Category	Micro	Small	Medium
Manufacturing	Sales turnover of less than RM300,000 OR employees of less than 5	Sales turnover from RM300,000 to less than RM15mil OR employees from 5 to less than 75	Sales turnover from RM15 mil not exceeding 50 mil OR employees from 75 to not exceeding 200 than 5
Services and other sectors	Sales turnover of less than RM300,000 OR employees of less than 5	Sales turnover from RM300,000 to less than RM3mil OR employees from 5 to less than 30	Sales turnover from RM3mil not exceeding 20 mil OR employees from 30 to not exceeding 5

The new definition is more comprehensive, covering all sectors of the economy including construction, as well as mining and quarrying sectors. It is expected to result in more firms being classified as SMEs to 98.5 per cent (currently: 97.3 per cent), particularly from the services sector to facilitate the country's transformation to a high income nation through the initiatives under the SME Masterplan. In year 2013, a total of 155 programmes have been planned for the implementation with a financial commitment of RM18.4 billion, expecting to benefit 467,838 SMEs.

With all the facilities provided by the government, SMEs should grab these opportunities to expand the businesses. However, the managers need to be equipped with latest knowledge and management skills to successfully manage their businesses in current business environment and stiff competition (Mohd. Amy Azhar, Harizal, & Hoe, 2010). In view of the fact that many entrepreneurs in Malaysia manage their business themselves without formal education background it lead to various management problems (Mohd Amy Azhar et al., 2010). One of the most common problems face by SMEs is financial management problem (Hashim & Wafa, 2002).

3. Financial Management of SMEs

Financial management is concerning with the creation and maintenance of economic value or wealth (Titman et.al, 2011). It involves decisions to accumulate and preserve wealth of the business. Generally it covers the decision making process in several areas such as determining the source of finance and dividend policy, investment decisions and working capital management. There is no big different between managing financial functions of big businesses or small businesses except that SMEs only deal with capital budgeting and working capital decision, given that SMEs are not paying dividends (Agyei-Mensah, 2011).

Comparative review on previous studies by Mohd Amy Azhar et al. (2010) suggested that financial management consist of six components; financial planning and control, financial accounting, financial analysis, management accounting, capital budgeting and working capital management. The study also highlighted that the adoption of financial management tools among Malaysian SMEs were very low. Seeing that most SMEs practicing proper financial planning and control, financial accounting and working capital management, these components were labeled as core components of financial management. Yet the other three components which were mostly neglected were labeled as supplement components of financial management.

A small scale study by Agyei-Mensah (2011) concluded that the influence of fund providers and external accountants are the most dominant factors stimulate SMEs to adopt reasonable financial management. On the other hand, due to lack of internal accounting staff and high cost to hire qualified accountant, SMEs face difficulties to understand accounting record and practice sound financial management.

4. Methodology

Semi-structured interviews were conducted among thirty five SMEs that were willing to participate in this study. The process of data collection took almost two months, due to the process of getting responses from the SMEs that were willing to participate in the study. The interview sessions were divided into two main sections. Section A was on demographic profile of the interviewees made up of various types of industries. This part asked for background information, which includes type of ownership, age of business, initial capital, source of capital, time spent to manage business, number of employees and owners' education background. The SMEs crossed the range of firm size, geographic location within Malaysia. Meanwhile, Section B focused on the financial management activities and related questions on the practices. Initially, to understand the behaviour of respondents, the data are first described using appropriate tables. Further analysis is conducted by categorizing the responses regarding strengths and weaknesses among participated SMEs and quantifying the results.

5. Results and Discussions

There were thirty five SMEs that participated in the study and their profile as presented can be categorized as sole proprietorship, partnership and company which consisted several type of businesses as viewed in Table 2

Table 2. Profile of participated SMEs

Item		Percentage (%)
Ownership	Sole proprietorship	77.5
	Partnership	18.0
	Company	4.5
Type of business	Food and beverages	53.5
	Agriculture, timber, fishery and farming	5.8
	Wholesale and trading	5.8
	Constructions	3.5
	ICT	2.3
	Professional services	2.3
	Logistics, import and export	2.4
Business age	0-3 years	19.5
	4-6 years	24.1
	7-9 years	13.8
	10 years and above	42.5

As for age of SMEs, more than half of the participated SMEs were between 0 to 3 years (19.5%) and followed by 4 to 6 years (24.1%), 7 to 9 years (13.8%) and finally more than forty percent of the SMEs aged 10 years and above. A total of 74% were bootstrapped from their own savings or borrowing from friends and relatives for initial capital. From the total, 25.88% dared to bootstrapped for the amount less than RM5,000; RM20,001 and above (43.5%). However, merely seven per cent had their initial capital from commercial banks and government grants where the amount was more than RM50,000. Surprisingly, nearly half (49.5%) of the business owners spent their time between 9 to 12 hours every day to manage their businesses.

It is important to know the educational background of the business owners because it showed the extent of their willingness in accepting new knowledge through training, seminars and workshops. These events were managed mostly by agencies under Ministry of International Trade and Industry (MITI) such as Pocket Talks by SME Corp., Domestic Investment activities by Malaysian Investment Development Authority (MIDA) and Innovative and Creative Circle (ICC) Convention by Malaysia Productivity Corporation (MPC). The government urges the SMEs to utilize the skills and knowledge gained from these events so that they could adopt prudent financial management.

Financial Strengths of SMEs

The overall response on the financial strengths of the business can be classified into several main aspects. The detail of the classification is summarise in

Table 3. Of the thirty five respondents, only 28 per cent of the participants pinpointed their financial strengths. Perhaps the other 72 per cent of the participants did not have any financial strengths or unable to identify their financial strengths due to lack of knowledge or education background.

Table 3. Responses on the financial strengths

Aspects of financial strengths	Detail	Percentage
Capital	No loan / own saving	26%
Financial stability	Generate profit	17%
	Profit were retained in the business	
	Higher profit during festive seasons	
Government supports	SME Corp	11%
	Majlis Amanah Rakyat (MARA)	
Cash basis	No debtors	9%
Record keeping	Systematic record	
	Professional accountant	
	Sound financial management	9%
Self management	Own management	6%
Affordable price	May offer discount to customers	11%
Other aspects	Effective file management	
	Self financial record	
	High resources	

The result showed 26 per cent of the responses indicated that running the business using their own capital as their main financial strength. However SMEs need to bear in mind that in order to expand their business in the future, more capital is needed. Therefore it is advisable for them to use financing facilities provided by the financial institutions or government entities in helping them to have stronger financial capabilities to run the business in more competitive world. Another 17 per cent of the responses indicate that financial stability as the financial strengths of their businesses, followed by support from government entities (11%), doing business on cash basis (11%) and other aspects as shown in

5.1. Financial Weaknesses of SMEs

Table 4.Responses on the financial weaknesses

Aspects of financial Weaknesses	Detail	Percentage
Capital insufficiency	Small / lack of capital	40%
Incomplete accounting record	Non systematic	16%
	Manual system	
	No cash register machine	
Financial performance	Only achieve breakeven	13%
	Deterioration	
Loan difficulties	Tough requirement	11%
	Competition	
High operating costs	High rental	7%
	High cost of raw materials	
Collection problems	Bad debt	7%
	Late payment from debtors	

In response to the financial weakness, more participants (33%) were able to identify their weakness, compared to their financial strengths (28%). 40 per cent of the responses stressed that the main aspect of financial weaknesses in running their businesses is capital insufficiency and followed by incomplete accounting record (16%). Deterioration in financial performance is listed as the third aspects, with the response rate of 13 per cent and the difficulties in obtaining loan from financial institutions and government agencies listed as the following aspects with 11 per cent response rate. A possible explanation for this might be that due to the problem in financial performance plus incomplete financial record, it might be difficult for the SMEs to obtain loan from any entities, causing them to face a problem of capital insufficiency to run their business efficiently. Among other responses revealed in the study as detailed in Table 4 are high operating costs and collection problems.

6. Conclusion

This study outlines the financial strengths and weaknesses of Malaysian SMEs. One of the most significant findings to emerge from this study is that, capital is the most critical financial component among SMEs. Running a business without any external capital (financing) shows the business is in a good financial condition. External financing may increase the risk of bankruptcy due to inability to settle the debt within agreed period. However, as the business keep growing, it is advisable for the SMEs to inject more capital to accommodate the expansion. Hiring appropriate staff may help SMEs in overcoming the constraints in applying for external financing through the preparation of proper accounting record and practicing prudent financial management.

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