

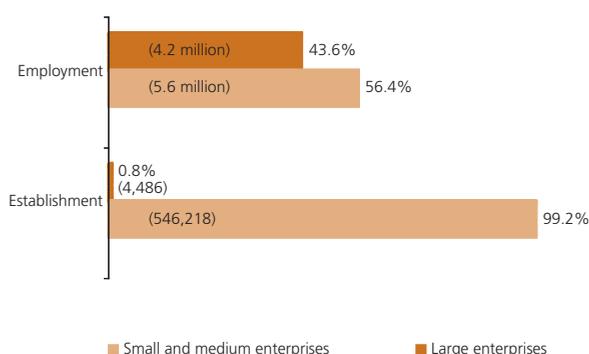
DEVELOPMENT OF SMALL AND MEDIUM ENTERPRISES

The development of a strong and dynamic SME sector is an important economic agenda of the Government. During the year, the National SME Development Council¹ (Council) had taken several key initiatives to promote the development of SMEs including strengthening the enabling infrastructure for SME development, building SMEs' capacity and capabilities, and improving the access to financing by SMEs.

Profile and Contribution of SMEs to the Economy

As the availability of data on the status and performance of SMEs is critical to facilitate the formulation of effective strategies and policies to support the development of SMEs, the Census of Establishment and Enterprise (Census) was conducted in 2005. Based on the response of 550,704 business enterprises in the agriculture, manufacturing and services sectors, the findings of the Census indicated that 99.2% or 546,218 of the business establishments are SMEs, of which 433,517 or about 80% are micro enterprises.

SME's Contribution to the Economy



The Census results also showed that SMEs are a major source of employment, providing jobs for over 5.6 million workers and accounting for 56% of total employment. While SMEs account for the bulk of business enterprises and employ the majority of workers, their contribution to the economy is relatively small. The SMEs contributed only about 19% to the total export value and 32% of gross domestic product. Similarly, productivity levels in the SMEs were found to be significantly lower than large enterprises as they generated an average value added per employee of just RM14,740, far lower than the RM47,830 generated by large enterprises.

Major Initiatives for SME Development

(i) National SME Development Blueprint 2007

The 2007 National SME Development Blueprint, which was endorsed by the Council in January 2007, provides an assessment of the major SME programmes implemented in 2006 as well as identifies programmes that will be implemented in 2007.

(a) Assessment of major SME development programmes in 2006

A total of 213 major programmes, involving a total expenditure of RM7.8 billion, were

¹ The National SME Development Council is chaired by the Prime Minister and comprised Ministers and Heads of 18 key Ministries and Agencies involved in SME development. Bank Negara Malaysia is the Secretariat to the Council.

implemented in 2006. The focus of the programmes was on enhancing the capacity and capabilities of SMEs, particularly in the areas of entrepreneurship development, marketing and promotion, product development and technology enhancement. These programmes benefited more than 287,000 SMEs. The major outcomes from these programmes were:

- More than 128,000 SMEs, women entrepreneurs, graduates and students received entrepreneurship and technical training;
- Advisory services were provided to about 34,000 SMEs by various Government agencies;
- More than 5,100 SMEs were provided with industrial and business premises;
- About 780 SMEs benefited from business matching and expansion programmes such as the Industrial Linkage Programme and SMIDEX 2006; and
- A total of 272 SMEs received grants and financial assistance to improve and upgrade their technology and business processes through the Technology Acquisition Fund, Grant for Certification and Quality Management System, and Grant for Product and Process Improvement.

To enhance access to financing by SMEs, Bank Negara Malaysia increased the allocation for the Fund for Small and Medium Industries 2 and the New Entrepreneur Fund 2 by RM2.5 billion in 2006, established a RM1 billion Special Fund for Overseas Project Financing and introduced two new trade financing products. Additionally, a RM150 million venture capital fund for the agriculture sector was established by Bank Negara Malaysia with a banking group. SMEs also benefited from financial advisory services provided by Bank Negara Malaysia, Bank Perusahaan Kecil & Sederhana Malaysia Berhad (SME Bank), Export-Import Bank of Malaysia Berhad (EXIM Bank) and commercial banks.

(b) Major Programmes for SME Development in 2007

The Council approved the implementation of 189 major programmes for SME development in 2007 (213 in 2006), with RM3.7 billion committed. Of the 189 major programmes, 135 programmes are aimed at building the capacity and capabilities of SMEs. Another 27 programmes will be implemented to enhance SMEs' access to financing, while 27 programmes are to strengthen the enabling infrastructure to further support the growth of SMEs.

These programmes cover all sectors, including SMEs in agriculture and agro-based industries, and those involved in knowledge-based industries. Efforts would also be directed to promote Bumiputera participation in the SME sector. To provide infrastructure to support SMEs' growth, business premises, factories and workshops will be provided for SMEs in the rural areas. In addition, product packaging, distribution and marketing centres will be established to ensure efficient and effective distribution of agriculture and agro-based products of SMEs. On strengthening the capacity and capabilities of SMEs, programmes will focus on entrepreneur and human capital development, marketing and promotion, and the provision of advisory services to SMEs. Highlights include the implementation of the New Franchise Scheme, Biotechnology Entrepreneur Development and ICT SME Development programmes. Various training programmes will be implemented, including in the areas of financial management and accounting, as well as to develop SMEs in the retail and agriculture industries.

In the area of financing, banking and development financial institutions will continue to be the main provider of funds to the SME sectors. These financial institutions are

expected to approve a total of RM51 billion in loans to about 110,000 SME accounts in 2007. This will be complemented by a target to approve 37,000 loans under the various Government schemes. Forty new companies in the ICT sector are expected to be financed under the ICT Fund, while the Biotechnology Commercialisation Grant aims to establish 35 projects.

(ii) Enhancing Awareness and Information Available to SMEs

(a) Launched of Inaugural SME Annual Report 2005

On 7 August 2006, the Council released the inaugural SME Annual Report 2005. The Report is an important initiative to enhance the dissemination of information on SMEs in Malaysia. It provides a comprehensive review on the status and performance of SMEs and highlights major programmes of the Government to promote SME development.

(b) Enhancements to SMEinfo Portal

The SMEinfo Portal (www.smeinfo.com.my), launched in January 2006, provides a wide array of information required by SMEs, including details on Government programmes, financial products, training programmes, and tips on how to start and manage a business. The Portal also contains the SME Business Directory, a platform for SMEs to advertise and showcase their products. The Portal is accessible in Bahasa Malaysia, English and Mandarin for greater outreach to the local and international business community. The SMEinfo Portal is used widely by domestic SMEs and foreign businesses, recording an average of about 205,000 hits a month, including visitors from over 70 countries. As at the end of February 2007, more than 14,000 SMEs have registered in the SME Business Directory Portal. In 2007, a number of new value-added services will be introduced, including the creation of an SME Bulletin Board to provide an avenue for public and private sector organisations to advertise SME related events and the SME Financial Product Directory, which will allow SMEs to search for suitable financial products to meet their business needs.

(iii) Establishment of the SME Business Adviser Network (SME-NET)

The SMEs have ranked the need for advisory services as high among the areas in which assistance is required. This includes advisory services in a wide range of areas including product development, technology adoption, business and financial management, marketing and promotion. In an effort to further strengthen the ability and quality of advisory services provided by the agencies and financial institutions, the Council approved the establishment of the SME-NET, a one-stop web-based directory in the SMEinfo Portal that contains the profiles and contact details of SME business advisers in the various Government agencies, commercial banks and development financial institutions. The SME-Net connects SME business advisers and experts across these organisations, and highlights specific areas of expertise, hence, enabling advisers to leverage on each other. The SMEs will benefit from the high quality and better delivery of advisory services in the areas of marketing, technology and operations management, human resource, financing, business development and product development.

(iv) Marketing and Promotion of SMEs' Products and Services

Following approval by the Council, the SME Marketing Committee, an inter-Ministry

Committee chaired by the Ministry of International Trade and Industry, has been established to develop a comprehensive marketing strategy and implementation approach to effectively market the SMEs' products and services overseas. The Malaysian External Trade Development Corporation (MATRADE) has been tasked to coordinate the implementation of international marketing programmes and activities. This two-pronged approach is aimed at enhancing the synchronisation of Government initiatives in planning and implementing overseas marketing strategies while optimising the utilisation of resources and expertise. The SME Marketing Committee has identified 14 strategies to further increase the penetration of the domestic SMEs' products and services in the global market. Comprehensive programmes will be implemented in 2007 by various Ministries and Agencies to assist in capacity building, promotion, information management and provision of financial support to facilitate our SMEs in marketing their products and services overseas.

Enhancing Access to Financing by SMEs

Lending by the financial institutions to SMEs has shown an increasing trend since 1998. In 2006, banking institutions, the main provider of funds to the SMEs, approved RM39.6 billion of financing to more than 84,000 SME accounts, an increase of 10.7% from 2005 (2005: RM35.8 billion). Loan disbursements increased by 19.9% to RM132.6 billion (2005: RM110.7 billion), while loans outstanding to SMEs expanded by 4.2% to RM104.6 billion as at end-2006 (end-2005: RM100.3 billion). Loans to SMEs accounted for 44.5% of total outstanding business loans as at end-2006 (end-2005: 44.5%). On a sectoral basis, lending to SMEs was diversified, with almost two-thirds being channelled to the wholesale and retail trade, hotels and restaurants, manufacturing and construction sectors.

In 2006, six development financial institutions (namely SME Bank, EXIM Bank, Bank Simpanan Nasional, Bank Kerjasama Rakyat Malaysia Berhad, Bank Pembangunan Malaysia Berhad and Bank Pertanian Malaysia) approved RM6.9 billion of financing to more than 18,000 SME accounts (2005: RM2.3 billion to 5,222 SME accounts) and disbursed RM3.7 billion to SMEs (2005: RM1.5 billion). The loans outstanding of development financial institutions to SMEs increased by 9.9% to RM13.2 billion as at end-2006 (end-2005: RM12 billion). Since its establishment in October 2005, the SME Bank approved and disbursed RM2.5 billion and RM1.6 billion in loans respectively. Its loans outstanding to SMEs stood at RM2 billion as at end-2006. Leasing and factoring companies, an alternative mode of financing equipment investment and working capital requirements, extended RM862.7 million of new financing in 2006 (2005: RM819 million). For newly established businesses, especially in the ICT sector, financing could also be obtained from venture capital companies. The total funds available for venture capital investments increased by 27.8% to RM3.3 billion as at end-2006 (end-2005: RM2.6 billion). These funds were invested in 460 companies compared with 380 companies as at end-2005.

Special Funds for SMEs

Currently, there are 94 Government funds and schemes with a total allocation of about RM25 billion to assist the SMEs. Five of these special funds were established by Bank Negara Malaysia with a total allocation of RM11.4 billion, to allow viable and eligible SMEs to have access to financing at reasonable costs (lending rates range from 3.75% to 6%). These funds are channelled through participating institutions comprising banking institutions, development financial institutions and ERF Sdn. Bhd. The five funds are:

- Fund for Small and Medium Industries 2 (fund size: RM6.75 billion);
- New Entrepreneurs Fund 2 (fund size: RM2.85 billion);

- Fund for Food (fund size: RM1.3 billion);
- Rehabilitation Fund for Small Businesses (fund size: RM200 million); and
- Bumiputera Entrepreneurs Project Fund (fund size: RM300 million).

Due to strong demand, allocations for the Fund for Small and Medium Industries 2 (FSMI2) and New Entrepreneurs Fund 2 (NEF2) was increased in 2006 by RM2 billion and RM500 million to RM6.75 billion and RM2.85 billion respectively. To ensure that these funds had a wider outreach, Bank Negara Malaysia revised the eligibility criteria of the FSMI2 and NEF2 in April 2006.

Initiatives to Improve Access to Financing by SMEs

The policy on enhancing access to financing by SMEs during the year continued to focus on strengthening the existing infrastructure to ensure a more effective channelling of funds to SMEs, provision of financial advisory support, as well as enhancing awareness on financial products and assistance programmes available to SMEs. Among notable initiatives introduced in 2006 were:

(i) Sustainable Microfinance Framework

The findings of the Census indicated that about 80% of SMEs are micro enterprises and most of them relied on their own sources of funding. Recognising this, the Council approved a comprehensive microfinance institutional framework to promote the development of a sustainable microfinance industry in Malaysia in order to ensure that micro enterprises have adequate and continuous access to financing. Within this framework, banking institutions, development financial institutions and credit cooperatives have been identified to provide microfinance products to complement the existing Government-sponsored microfinance programmes such as Amanah Ikhtiar Malaysia and Yayasan TEKUN Nasional.

With the introduction of the microfinance framework, several financial institutions have started to provide individuals and micro enterprises with fast, flexible and convenient access to financing for business purposes. Banking institutions have now launched microfinance products since December 2006. Microfinance products offered by the financial institutions have attractive features, with loans sizes ranging from RM500 to RM50,000. To provide the widest accessibility, flexible collateral requirements, fast loan approvals (ranging between 5 to 11 working days) and incentives to encourage good repayment practices by borrowers are incorporated into the microfinance products.

The Council also agreed that a common microfinance logo will be developed to create awareness on microfinance. Financial institutions that offer microfinancing will display this logo to enable and enhance public awareness on financial institutions that offer these services. Recipients or borrowers of microfinancing facilities will also be encouraged to display this logo at their business premises. Bank Negara Malaysia is also facilitating the development of a "Graduation Programme" to enable the larger micro enterprises to obtain the right amount and type of financing. Through this structured programme, micro enterprises that require larger amount of funds to finance business growth will be assisted in obtaining financing from the appropriate financial institutions.

(ii) Venture Capital Funds for the Agriculture Sector

To support the objective of developing the potential of the agriculture sector as the third engine of growth, two venture capital funds totaling RM350 million were jointly

established in September 2006 by Bank Negara Malaysia, Khazanah Nasional Berhad and a banking group. The aim of these funds is to create and develop an integrated agricultural business, particularly in farming, fisheries and livestock as well as to finance new technology-intensive agriculture projects. Another agriculture venture capital fund will be launched with a banking group amounting to RM150 million in the first half of 2007.

(iii) Overseas Project Financing

Bank Negara Malaysia established a RM1 billion Overseas Project Fund at EXIM Bank in December 2006 to facilitate Malaysian companies with projects overseas in obtaining financing from the domestic banking institutions through the guarantee and co-financing facilities under the Fund. Under the guarantee facility, EXIM Bank will provide guarantees to loans obtained by eligible companies to finance overseas projects from the domestic banking institutions. With this credit guarantee facility, Malaysian companies, contractors and professional service providers will have an easier access to financing to support their business ventures abroad. Currently, four domestic banking groups are participating in the guarantee scheme.

(iv) SME Bank's Advisory Services

The SME Bank established the SME Bank Advisory Centre (SAC) to help SMEs grow, innovate and achieve excellence in their business activities as well as to overcome financial problems. The advisory services provided by the SAC include advice on marketing, business development, operations and customer service.

(v) New trade finance products

Two new trade finance products for SMEs were introduced in January 2006, namely the Multi Currency Trade Finance and Indirect Exporter Financing Scheme. These products are aimed at encouraging SMEs to export their goods and services, particularly to non-traditional markets such as members of the Organisation of Islamic Conference. Under the arrangement, SMEs can obtain financing without collateral from the banks, with the credit risk being shared between the bank and EXIM Bank. Financing approved to the SMEs under the two products amounted to RM26.1 million as at 31 December 2006. Islamic trade finance products are expected to be available to SMEs in 2007.

Financial Advisory Services

The LINK (Laman Informasi Nasihat dan Khidmat) in Bank Negara Malaysia provides financial advisory services to SMEs in the following areas:

- information on various sources of financing;
- assistance in facilitation of the loan application process; and
- advice on financial requirements and problems of SMEs.

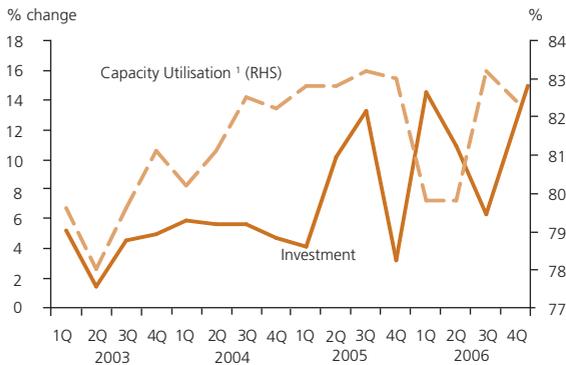
In 2006, the number of enquiries and assistance sought by SMEs totalled 4,186 (2005: 4,037) reflecting continued awareness among SMEs of availability of such services at the Bank. Of these, 77% were enquiries on special funds provided by the Government and advice on loan matters, while 23% were requests for assistance, mainly for loan restructuring and rejections.

Performance of the Small Debt Resolution Scheme

The Small Debt Resolution Scheme, established on 1 November 2003, continued to facilitate the

restructuring of non-performing loans (NPLs) of SMEs with on-going businesses. As at end-2006, 562 applications for restructuring, with NPLs of RM405 million, were received under the scheme (end-2005: 394 applications with NPLs of RM278 million). Of these, 424 applications or 75.4% of the total applications, involving NPLs of RM267 million, have been approved for restructuring. In terms of applications for new financing, RM301 million in new funding was requested (end-2005: RM244 million), of which RM18 million was approved under the Rehabilitation Fund for Small Businesses. The performance of the scheme indicates that the restructuring of NPLs continues to be the mainstay in supporting the viability and sustainability of financially distressed SMEs, with new financing being selectively provided mainly to SMEs with new projects in hand.

Chart 1.8
Investment and Capacity Utilisation



¹ Source: Malaysian Institute of Economic Research (MIER)

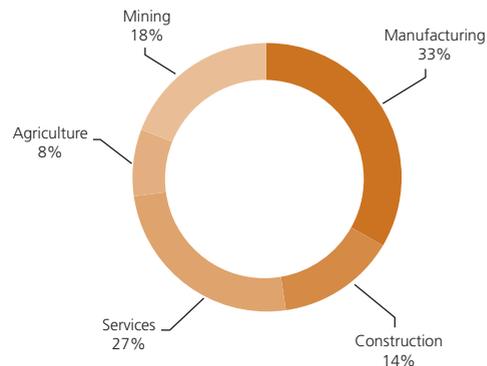
expansion in capital spending occurred in the manufacturing, services and upstream oil and gas sectors.

Manufacturers' expenditure on new machinery and equipment remained strong, as reflected in the higher imports of these items during the year. In view of the strong demand for resource-based products from abroad and sustained high capacity utilization levels, manufacturers undertook a significant expansion in capacity. The expansion of production capabilities in the off-estate processing industry also reflected a strong expansion in the commodities-related downstream sector in expectation of strong demand. In 2006, the Ministry of International Trade and Industry (MITI) approved 1,077 manufacturing projects worth RM46 billion (2005: RM31.1 billion), mainly for investment in the petroleum products, chemical products and electrical and electronics products

industries. The bulk of the approved projects were new and mainly concentrated in biodiesel production, which is in line with Government's aspiration to promote the development of biofuels. At the same time, there was an increase in capital spending to expand current production lines, mainly in the electronics sector, where foreign participation is more prominent. For the projects approved during the year, capital investment per employee also rose, pointing to the shift towards more capital-intensive and higher value-added projects.

Capital spending in the oil and gas sector remained robust, driven by exploration and production projects as deepwater exploration intensified during the year. In the services sector, investment was most notable in the transportation

Chart 1.9
Private Investment by Sector (% share)



2006