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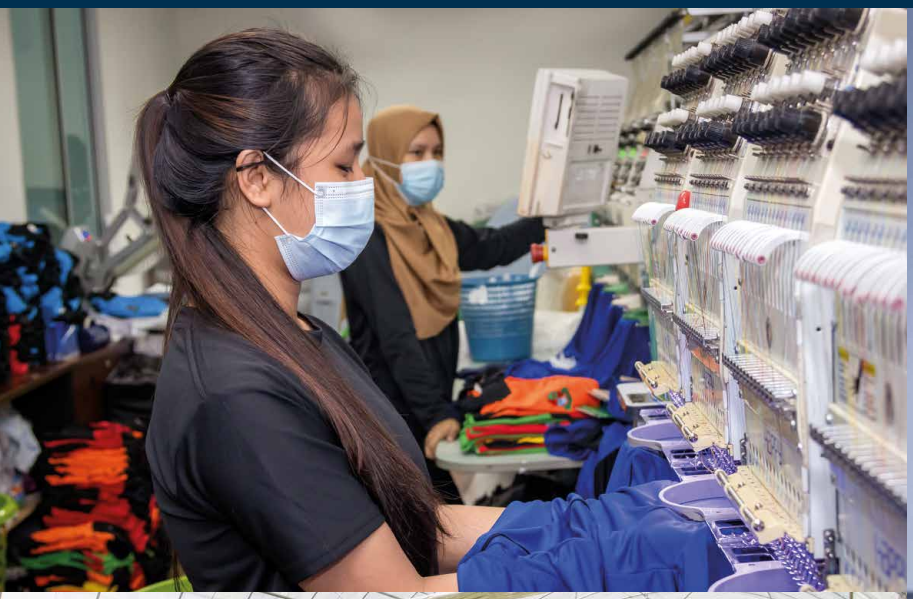
Malaysian SME Program Efficiency Review

MARCH 2022



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MARCH 2022

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Acronyms and Abbreviations

ASEAN	Association of Southeast Asian Nations
B40	Bottom 40 Percent
BNM	Bank Negara Malaysia
BPS	Business Pulse Survey
BRICS	Brazil, Russia, India, China, and South Africa
CGC	Credit Guarantee Company
CMCO	Conditional Movement Control Order
CEO	Chief Executive Officer
DOSM	Department of Statistics Malaysia
E&E	Electronic and Electrical
EAP	East Asia and Pacific
FDI	Foreign Direct Investments
GDP	Gross Domestic Product
GERD	Gross Expenditure on Research and Development
GLC	Government-linked Company
GVC	Global Value Chains
HIP	High-impact Programs
IMP	Industrial Masterplan
KPLB	Ministry of Rural Development
LFPR	Labor Force Participation Rate
MCO	Movement Control Order
M&E	Monitoring
MEDAC	Ministry of Entrepreneur Development and Cooperatives
MITI	Ministry of International Trade and Industry
MNE	Multinational Enterprise
MOSTI	Ministry of Science, Technology and Innovation
MSMEs	Micro, Small and Medium Enterprises
NEM	New Economic Model
NEP	National Entrepreneurship Policy 2030
NESDC	National Entrepreneur and SME Development Council
NSDC	National SME Development Council
OECD	Organization for Economic Co-operation and Development
PER	Program Efficiency Review
R&D	Research and Development
RCA	Revealed Comparative Advantage
RCEP	Regional Comprehensive Economic Partnership
SME	Small and Medium Enterprise
SMEIPA	SME Integrated Plan of Action
SMIDEC	Small & Medium Industries Development Corporation
SST	Sales and Services Tax
TFP	Total Factor Productivity

Summary

This report is intended to assess the adequacy and appropriateness of Malaysia's current SME support policy framework and the coherence of its related policy and program mix in terms of its ability to support the government's efforts to facilitate greater innovation-led productivity growth. Initiated at the request of the government to inform SME policy making, the study aims to provide timely inputs in the context of the current crisis and to assist policy makers in their efforts to recalibrate support programs to better meet the needs of SMEs.

With SMEs constituting a large proportion of Malaysian enterprises and making significant contributions to employment, GDP, and exports, it is vital for the achievement of Malaysia's development aspirations that these SMEs are enabled to achieve higher levels of productivity and performance. In 2020, SMEs (including microenterprises) account for approximately 97.2 percent of business establishments in Malaysia, contributing to 48 percent of national employment; 38.2 percent of overall GDP; and 13.5 percent of the nation's overall exports (DOSM 2021). Overall, Malaysia's productivity growth has been declining over recent years, intensifying the challenges related to achieving a convergence between Malaysia's economy and those of high-income nations. Due to their significant role in Malaysia's private sector, SMEs would have to play a more significant role in improving overall productivity and performance if this convergence is to be achieved.

There are large variations in terms of total factor productivity (TFP) between firms of different sizes in Malaysia, with small firms generally lagging far behind larger firms.[1] In Malaysia, firms in the top 25 percent of TFP distribution are 11.6 times more productive than those in the bottom 25 percent. This is a vastly greater gap than in the case of China and of comparators from the OECD and ASEAN region, where the average gap is less than 4 times (World Bank 2018). Much of this high degree of variability is explained by differences between the average TFP levels of large and small firms, which have wider TFP distributions than medium-sized firms. This implies a greater proportion of SMEs in Malaysia are inefficient than is the case for its global peers.

Malaysia's exports are dominated by large firms, with SMEs performing much less well in terms of integration into global value chains (GVCs). It is estimated that less than 5 percent of small businesses in Malaysia have exports that account for 10 percent or more of overall sales/revenue. For medium businesses, the figure stands at 15 percent, while for large businesses that export, it stands at 50 percent.

Malaysian firms in general, but most particularly its SMEs, face a number of fundamental issues and challenges related to innovation and the adoption and effective use of new technologies. These issues have become even more compelling in the current uncertain global context, with the pandemic increasing the need for innovation and technological uptake for businesses to remain competitive. At present, the share of small and medium Malaysian firms that invest in R&D is lower than is the case for a number of regional ASEAN comparators. Malaysian firms also tend to lag in terms of the adoption of digital technologies compared to other upper-middle income countries, especially in the case of SMEs (World Bank 2018). Additionally, Malaysia's SMEs are less likely to adopt complex innovations and technologies in their business operations and management practices due to a lack of technical capabilities (World Bank 2020a).

1 The firm level TFP analysis applied only to manufacturing firms.

The effects of the rapid evolution of the modern business environment that have resulted from the introduction of innovative new technologies and business practices have been exacerbated by the current high level of uncertainty related to the pandemic, placing increased emphasis on the need to improve firm capabilities. The COVID-19 crisis has forced businesses to adapt and adopt digital tools in order to operate in the current environment. However, for these digital technologies to effectively enhance firm productivity and competitiveness, firms need to have the requisite skilled personnel to utilize them. While digital and technological skills play a crucial role in the current business environment, other skills, including managerial and organizational skills, also play an important role in increasing firm-level productivity and in enabling firms to innovate, to weather the crisis, and to emerge from it more resilient.

Most Malaysian SMEs rely on informal sources of funding. A survey conducted by Bank Negara Malaysia (BNM) in 2018 found that SMEs rely heavily on informal sources of funding, mainly self-financing (approximately 51 percent), followed by funding from family and friends (17 percent). In total, 27 percent of respondents reported receiving financing from financial institutions, the majority of which were banks. Predictably, younger SMEs rely to a greater extent on self-financing, with increasing use of external financing as they mature. While the share of finance provided by financial institutions to SMEs has increased over the past decade, SMEs continue to report constraints on access, particularly related to their inability to provide sufficient collateral.

> ***In sum, while SMEs comprise the majority of firms in Malaysia, they experience far larger productivity gaps than do either large firms or SMEs in regional peer countries, lagging behind in terms of effective integration into global value chains. They also lag in terms of the adoption of digital technology and investments in R&D, and mostly rely on informal sources of funding.***

Given the considerable fiscal challenges resulting from the pandemic, there is an urgent need to recalibrate Malaysia's provision of public support for SMEs to enable the post-pandemic recovery to be driven by the private sector. Prior to the crisis, the combined impact of a persistent decline in revenue and increased committed expenditures had already narrowed the Malaysian government's fiscal space, with the increased public spending in response to the pandemic exacerbating this situation. In this context, the medium-term objective of the government's fiscal policy will need to be on rebuilding fiscal buffers through fiscal consolidation, limiting the government's scope to leverage fiscal policy to achieve medium-term growth. This places an additional onus on the private sector to lead the growth process. Additionally, the role of government policy will need to shift towards facilitating private sector growth, emphasizing the need for the more efficient execution of policies and programs to support the private sector, particularly the SMEs.

In this context, the overall objective of this study is to analyze the composition of Malaysia's SME and entrepreneurship support policies so as to identify opportunities to decrease redundancies and to increase efficiencies by ensuring that public support towards SME development responds effectively to the most pressing needs of SMEs. Over the years, the Malaysian government has introduced, implemented, and revised numerous instruments and programs to support a wide range of SME activities. For this study, 275 different SME and entrepreneurship support programs and instruments have been meticulously mapped onto a matrix containing detailed information regarding each SME program. The value of Malaysia's programs in proportion to GDP is relatively high compared to other countries, standing at almost 1 percent of GDP in 2018 and at 0.63 percent in 2019.[2] In order to identify opportunities to improve the efficiency of the policy mix, a redundancy analysis has been conducted to investigate potential redundancies in the policy mix.

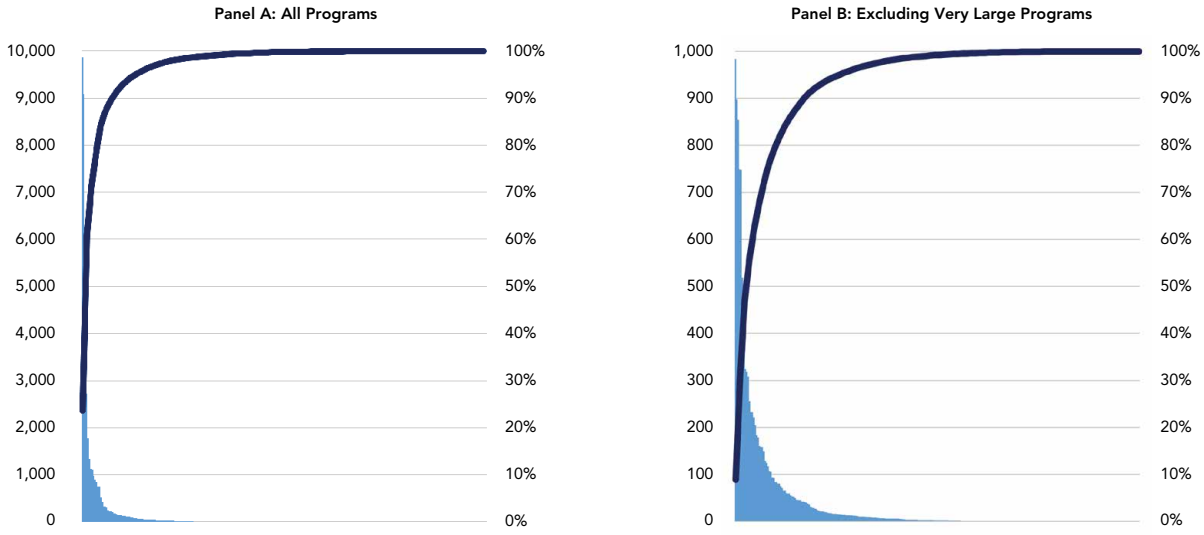
2 Philippines spends around 0.15% of GDP whereas Czech Republic at around 0.4% of GDP for their latest available year.

Data provided by SME Corp has been combined with information sourced both from program documentation and communications with senior managers at a number of implementing agencies. It is important to note that the programs covered in this program efficiency review (PER) are those that are reported under the SME Integrated Plan of Action (SMEIPA), which are mostly implemented by government agencies or government-linked institutions. It thus does not capture instruments such as tax incentives[3] for SMEs or development programs that are wholly funded through private sector initiatives. It is also important to highlight that these programs include all programs that SMEs could apply to, and thus includes those that are also open to large firms. The analysis, however, has been restricted to SMEs.

Malaysia's portfolio of SME support programs largely consists of programs that provide loans to firms and grants that finance technical assistance through the provision of training and education for SMEs and entrepreneurs. In addition, among a wide range of other mechanisms, these programs use credit guarantees to support firms. Credit guarantees are arrangements according to which an agency guarantees to provide collateral or to secure the lending transactions of SMEs in the event of default. Additionally, the value of the programs in this study refers to the sum of operating expenditures incurred by the agencies to implement the program, together with the actual disbursements made to beneficiaries. It should be noted that the values of credit guarantees are tied to the disbursed loans or credit.

The size and the value of the disbursed funds across all programs vary greatly, with a high degree of concentration of overall disbursements in a few programs. An analysis of all programs implemented in the period from 2016 to 2019 shows that a large proportion of the disbursements are concentrated in only a few programs. In fact, the five largest programs account for more than 80 percent of the total value of disbursements (see Figure i Panel A), all of which are large programs that offer loans to SMEs. At the same time, there is a great number of small-sized programs, often with very similar, generic objectives. Similar patterns can be observed when the largest programs are omitted from the distribution (see Figure i Panel B).[4] Though the

Figure i: Distribution of SME and Entrepreneurship Programs (disbursement in RM Millions aggregated from 2016 to 2019)



Source: World Bank staff calculations based on SMEIPA data

3 Some of the key tax incentives were acknowledged in this study but due to the lack of data available, they were excluded from the main analysis.
4 This refers to the programs that have total disbursements larger than RM10 billion within the 2016 to 2019 period.

disbursements are less concentrated, larger programs (from this subset of programs) still persistently account for a substantial share of overall disbursements, with most other programs operating at a small and sometimes miniscule scale.

The involvement of a large number of ministries and agencies in these programs leads to a high degree of fragmentation, decreasing the efficacy of program implementation. In the period from 2016 to 2019, more than 270 different SME support programs were implemented by more than 80 different agencies across almost all the line ministries. Though SME Corp is the central coordinating agency for SME and entrepreneurship programs, implementing more than 150 different programs each year certainly creates significant coordination challenges for this entity.

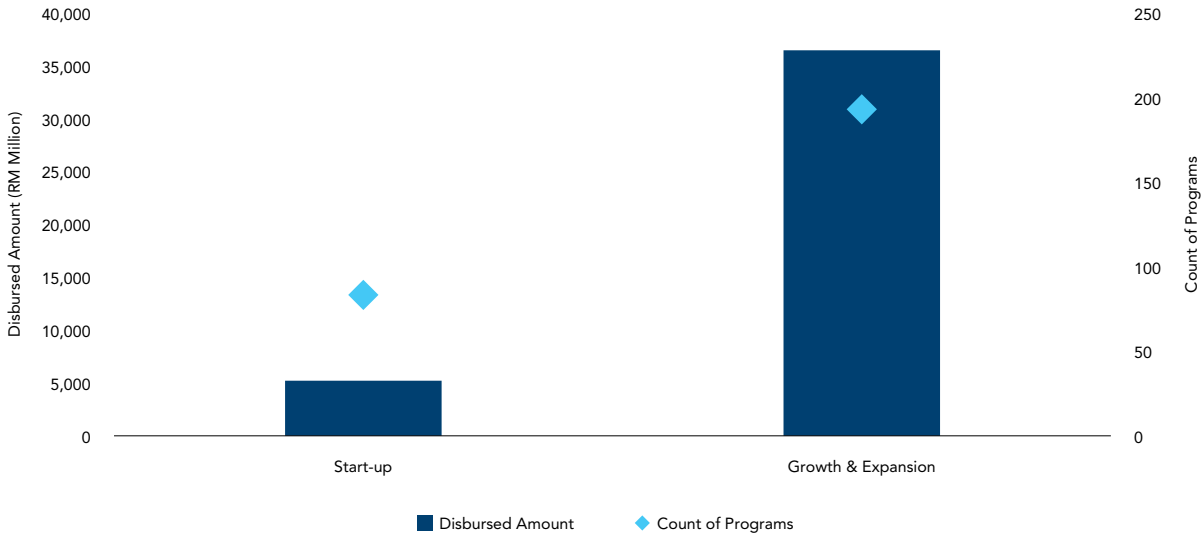
Most of these SME and entrepreneurship support programs are primarily focused on providing support during the growth and expansion stages of SMEs. A breakdown in terms of business life cycle shows that all programs in the portfolio can be divided between those that target either startups or firms in the growth and expansion stages. The data show that a significantly larger number of programs and disbursements were focused on growing and expanding existing SMEs, with programs in this group accounting for more than 190 different programs and RM36.5 billion (approx. US$ 9 billion) in disbursements in the period from 2016 to 2019 (see Figure ii). These programs aim at growing existing SMEs, in contrast to programs that focus on developing potential businesses at the ideation stages and on facilitating the creation of new businesses and growing very nascent businesses. Programs of the second sort can be classified as 'start-up' focused programs, with programs in this category accounting for just over 80 programs and RM5.2 billion (approx. US$ 1.3 billion) in disbursements within the same time period.

Despite the emphasis on providing support during firms' growth and expansion stages, there has been only limited improvements in SME-level productivity, thus calling into question the efficacy of the program mix and the support it provides. While SMEs' contribution to GDP, exports, and employment have increased steadily over the years, these contributions have not even come close to the targets established in the SME Masterplan. Additionally, the level of productivity of SMEs in Malaysia is significantly lower than in other countries, with Malaysia's overall productivity growth rates also declining. Despite the tremendous amount of support provided by the government to facilitate increased growth, expansion and productivity enhancement (see Figure ii), productivity growth has not improved to the extent that would enable Malaysia to catch up with its aspirational peers.

The disbursements for Malaysia's SME support programs have been concentrated in programs intended to increase the general capacities of SMEs, with a distinct lack of programs that target their specific needs, including measures to support business R&D, improved management practices, and firm linkages. Looking at the relative value of the disbursements for programs broken down in terms of intermediate objectives, it can be seen that approximately 50 percent of the overall value of disbursements was allocated to programs that supported the general capacity expansion of SMEs, largely through the provision of finance to obtain fixed assets and working capital. There tends to be a general objective of enabling SMEs and entrepreneurs to expand their productive capacity or facilitating general business expansion that does not fall into other intermediate objectives.[5] Programs and instruments that target the specific needs and deficiencies of SMEs, including those related to business R&D, management practices, and firm linkages, account for a relatively small proportion both of the total number of programs and of total disbursements, despite the fact that these areas of firm support can play a critical role in facilitating the success of SMEs in their efforts to

5 These tend to be objectives that aim to further expand the productive capacity of SME or entrepreneurs but does particularly target other intermediate objectives. They are largely comprised of programs that provide general financial support towards SMEs their beneficiaries.

Figure ii: Disbursed Budget and Total Number of Program by Targeted Stages of Programs (aggregated from 2016 to 2019)



Source: World Bank staff calculations based on SMEIPA data

boost innovation and productivity performance. While programs to support technology adoption and non-R&D innovation have increased in terms of their share of the total *number* of programs, this has not translated into an increase in the total value of the disbursements for these programs.

Malaysia's program portfolio differs vastly from that of other countries for which a similar analysis has been conducted. Malaysia's general intermediate objective for SME and entrepreneurship development is largely focused on the expansion of firms and entrepreneurs. Other nations, such as the Czech Republic, have a wider range of objectives than does Malaysia, with a greater focus on non-R&D innovation, entrepreneurship and business R&D (World Bank 2019a). These objectives directly support the achievement of the overarching economic goal of productivity growth. In the Philippines, the policy mix tends to focus to a far greater extent on skills formation, market access, and management practice (World Bank 2020g).

While a large number of Malaysia's programs focus on upscaling SMEs and developing entrepreneurship through the provision of training and advisory services, their share of total disbursements remains small. Assessing the number of programs by mechanisms of intervention, those that focus on the provision of education and training for SMEs account for more than half of the total (approximately 51 percent), followed by those that provide business advisory or technology extension services (approximately 32 percent). This is in line with the government's broader objective of scaling up Malaysia's SMEs and fostering greater entrepreneurship, directly supporting the intermediate objectives of the programs. However, in terms of disbursements, programs that involve the provision of financial support for SMEs and entrepreneurs, largely through the provision of loans or credits, continue to account for the greatest share. Approximately 50 percent of the total value of disbursements for all SME programs in the period from 2016 to 2019 involved the provision of financial support, with loans and credits accounting for the greatest proportion of the total disbursements for these financial support programs, at approximately 58 percent. Additionally, a small number of programs (nine) involved hybrid or mixed mechanisms.

The current economic crisis creates challenges for policymakers in their endeavors to balance the need to provide immediate relief to SMEs with the need for the re-allocation of resources and the recalibration of priorities to facilitate the achievement of longer-term, productivity-led growth. Ideally, policymakers should target the more productive of the firms currently facing distress. However, productivity can usually only be assessed with a significant time lag. This raises the importance of viability assessments as a key determinant to target support to firms facing distress. These viability assessments should be conducted on the basis of factors such as solvency, vulnerability, size and long-term considerations related to a firm's resilience. A few principles could help policymakers maximize the effectiveness of their interventions. In the short and medium term, interventions should start with the provision of relief to facilitate the recovery of SMEs, before moving to policies that support long-term resilience and growth.

Organization, Management and Redundancies of Programs

Overlaps between the programs implemented by a wide range of ministries and agencies arise due to programs having very similar, generic objectives, which points to a need to strengthen coordination across ministries and to streamline the large number of existing programs. To identify opportunities to improve efficiency, a redundancy analysis has been conducted to investigate potential redundancies in the policy mix. The analysis shows that a considerable number of programs overlap with each other, with only very nuanced differences between them. Overlaps across ministries and agencies arise due to programs having generic objectives. The present crisis creates an opportunity to examine the needs of the SMEs more closely and to recalibrate support programs so that they effectively target these needs. In doing so, a consistent effort needs to be made to use accurate, relevant data to inform future policy making. An overarching strategic and policy framework that governs SME development akin to an SME Masterplan could play a positive role in guiding the design, implementation, and coordination of SME programs in the country.

RECOMMENDATION 1: Enhance governance around SME development, reporting, data management and transparency of programs by implementing agencies.

Given the number of agencies and ministries involved in SME development, there is a need to strengthen the governance structure to have a strong apex organization that has the convening power to bring together the various initiatives under a coordinated mechanism. To be effective, the mandate/mission of this apex body such as SME Corp needs to be aligned to the overall SME development objectives for Malaysia and needs to be clearly understood by all stakeholders involved. Previously, World Bank (2020e) also argued that the governance of an independent SME Corp through the NESDC will continue to be an important platform for policy decisions on SME development and implementation of the SME Masterplan.

At present, there is no standard way of defining the programs from the SMEIPA to report on their achievements, with a lack of separation between programs and activities in some cases. This makes it hard for policymakers to conduct a meaningful program efficiency analysis. The cluster analysis also revealed a number of significant disparities in the reporting practices for different programs within the portfolio. Some programs are separated into different categories to account for subtle differences in their components and activities, whilst other programs aggregate seemingly very different activities with diverse scopes into a singular program. It is also important to consider the means by which the transparency and data availability related to the SME programs could be improved, including through breakdowns of fund transfer mechanisms and data that enable a clear assessment of how funds are utilized for each program.

Detailed program information is also essential to enable an effective analysis of the reach of the programs so as to facilitate more effective targeting, particularly including information that provides a full breakdown of beneficiaries (by size or different target groups) and of budgets and expenditures at the program level. Information related to these programs should be made more widely available to achieve greater transparency and accountability. Weak monitoring systems and reporting practices prevent effective impact evaluations from being conducted, which in turn constrains future policy making. A more robust monitoring system should also be applied to the budget allocation process for these programs. In addition, a model of budget allocation that rewards programs that provide effective coordination and end-to-end facilitation to address key constraints to SME growth and competitiveness will be key to successfully creating a more coordinated approach to SME development.

RECOMMENDATION 2: Consider merging programs that have considerable overlaps in objectives, mechanisms, and beneficiaries to avoid redundancies and to eliminate programs that are too small to be effective.

The cluster analysis shows that a large number of Malaysia's SME support programs are characterized by redundancies and overlaps. Based on the results of this cluster analysis, a thorough re-evaluation of the current portfolio of SME and entrepreneurship development programs should be conducted to identify programs for which further action may be required. Additionally, this process may enable the rescaling of certain small programs that may not be effective due to their relatively small scale.

Building Capabilities and Leveraging Productivity-improving Technologies

The current crisis creates an opportunity for the government to recalibrate its programs to promote private sector growth on the basis of the identified needs of SMEs. Over the years, the Malaysian government has introduced, implemented, and reformed numerous instruments and programs to support a wide variety of SME activities. With new programs being designed to expedite the recovery of the private sector, there is an opportunity to recalibrate program support towards priority areas, such as through initiatives to build the digital capabilities of SMEs to increase private sector growth and resilience. Other areas of support could include measures to increase SME capabilities to produce environmentally sustainable products. With increasing attention being given by large multi-national corporations (MNCs) to compliance with environmental, social and corporate governance (ESG) standards, these support measures for SMEs could enable them to successfully integrate into reconfigured global value chains (GVCs) that require compliance with these ESG standards. In the design of these programs, the establishment of linkages with the private sector could play a pivotal role in facilitating feedback mechanisms that inform policy design and implementation.

RECOMMENDATION 3: Recalibrate SME programs to support SME digitization.

The BPS survey conducted in February 2021 found that while a significant portion of firms did make some investments in digital solutions, many were constrained by limited access to finance from doing so, with this being the most commonly cited reason for not making such investments, followed by a lack of information and lack of certainty regarding the benefits to be derived from these investments. Further, the rates of investments were largest in the larger firms, followed by medium-sized firms. While the most common use of digital platforms relates to sales and marketing, there has also been significant adoption of digital technologies to facilitate more complex functions, such as production and supply chain management, by large firms. The government has

articulated Malaysia's aspirations to achieve the successful transformation of the country into a digitally driven, high-income nation and the regional leader in the digital economy through the *MyDigital* Blueprint. For the government to facilitate the achievement of these aspirations, it needs to promote the increased uptake of more complex technologies in order to enable SMEs to achieve productivity dividends. In fact, despite the already high proportion of firms that have adopted digital technologies, the vast majority of firms (90 percent or more of those surveyed) stated that they would benefit from government assistance to promote the increased adoption and uptake of digital solutions, to mitigate the negative impacts of the COVID-19 crisis.

RECOMMENDATION 4: Rebalance the policy mix

Looking at Malaysia's current SME support policy mix, it can be seen that most programs are primarily focused on providing support during the growth and expansion stages of SMEs, with programs of this sort accounting for 87 percent of the total value of program disbursements. While the government has recognized the need to rebalance this through the introduction of programs that focus on the earlier stages of the business cycle, the program mix should also focus on measures to enable the emergence of a greater number of startups. A study on the start-up financing ecosystem, World Bank (2022) shows that in Malaysia, there are two main funding gaps in firms' lifecycle. The first gap occurs in the ideation stage, during which a business develops a minimum viable product, while a second relates to the early-stage series funding in the Series A and B rounds. Traditionally, the government has played a key role in providing support during the ideation stage, due to the high level of risk aversion in the private funding space. However, in recent years, the focus of government grant funding has been shifting away from this phase to concentrate on the commercialization stage of the firm's lifecycle (e.g., Cradle Fund). World Bank (2022) provides concrete recommendations to recalibrate government support programs and incentives to crowd in private investments in this space.

Productivity gaps between SMEs and larger businesses can be attributed both to low levels of technology adoption and diffusion and to weaknesses in firms' capabilities and managerial practices. At the same time, the current business climate increases the urgency for SMEs to digitalize and adopt technologies that improve productivity. Although programs exist to support SMEs in their endeavors to improve managerial practices and quality standards, these programs are usually very small compared to programs that support other activities/ objectives.

RECOMMENDATION 5: Enable productivity improvements in SMEs through support for enhanced managerial practices within SMEs.

It is important to foster a commitment to lifelong learning among both managers and employees and to reinforce efforts to close the skills gaps between Malaysia's SMEs and large companies and between Malaysian SMEs and SMEs in other countries. The World Bank (2020f) study presents a number of policy recommendations to address gaps in managerial practice. Efforts to close skills gaps could be reinforced through strengthened workforce training programs, with coordination with the private sector to improve the effectiveness of existing training interventions and to alleviate skill mismatches in industry and the labor market.

Policies and programs that facilitate the diffusion of information and that provide hands-on support for good management practices can be crucial towards improving the quality of these practices. The diffusion of information related to best practices and the provision of support to SME managers to critically evaluate their own practices in a non-threatening way could be particularly cost-effective. In terms of targeting, these interventions should prioritize firms where self-assessment gaps between actual and self-reported management practices are most pronounced, particularly in the case of smaller and younger firms. In addition to the diffusion

of information, the provision of hands-on support to implement modern management practices can improve productivity (Bloom et al. 2013). While Malaysia already implements some such support, it could strengthen and scale up these efforts. Existing programs with limited emphasis on improving managerial practices could revise their focus to include such components into their programs.

Additionally, SMEs (especially family-owned firms) have significant potential to leverage external management services and consultancies to adopt international quality standards that could improve their ability to achieve increased growth, greater exports, and closer linkages with suppliers. Interventions could focus on upgrading managerial capacity, with the promotion of these services among family-owned businesses, including through SME associations, regional authorities and intermediaries. The realization of productivity gains through improved management practices will necessitate increases in the intensity of competition, reforms to the ownership structure of firms, and investments to enable access to talent through higher quality education and training.

RECOMMENDATION 6: Establish closer linkages between programs that support upskilling and that provide training with those that support the increased uptake and adoption of technology.

While there are numerous programs that provide training, financing and advisory services for SMEs, a large proportion of these programs provide financing for the procurement of fixed assets, such as premises or machineries. This relatively unconstrained funding could reduce the effectiveness of these funds. Funding should have clearly specified targets, with clarity regarding the purpose and means by which these programs are intended to achieve the specified targets. Programs that provide funding to SMEs to increase technological uptake should also include the appropriate support for training or advisory services for these new technologies to ensure the SMEs reap the optimal benefits from the adoption of these new technologies.

SME Innovation Capabilities and R&D

In Malaysia, private-sector R&D is largely driven by foreign-owned or large firms. In recent years, business R&D has taken a hit, with some businesses shifting R&D away from Malaysia. There is limited demand for innovation and R&D amongst SMEs, which makes it more difficult to facilitate the emergence of domestic innovation champions. Furthermore, there is only a limited number of support programs that encourage business R&D. Although there are some general incentives to encourage R&D, few of these are specifically intended to support SMEs. The promotion or introduction of incentives to specifically encourage R&D on the part of SMEs could further support improvements to their R&D capacities.

RECOMMENDATION 7: Innovation support programs to crowd in private investments in early-stage financing.

Incubators and accelerators remain integral to the foundation of the start-up ecosystem, playing a vital role in seeding strong start-up deal close. They also play a key role in the entrepreneurship ecosystem by mentoring and identifying healthy deal-flow pipelines at the ideation stage in a highly risk averse context. As stated earlier, there is an existing funding gap in the ideation and the early-stage series funding for startups in Malaysia. In this context, a re-direction of government funds towards private-sector-managed incubators and accelerators could crowd-in increased private funding in this space (see World Bank (2022) for details).

SME Innovation Linkages

Establishing and expanding the technical know-how and knowledge of SMEs can boost productivity and support economic growth. One of the means by which this could be achieved is through increased collaboration between SMEs and universities and/or MNCs, with these linkages having the potential to create technological spillovers and knowledge transfers. At present, weak collaboration and knowledge linkages constrain the development of regional innovation systems, with a distinct lack of collaboration between SMEs and academic institutions (World Bank 2020a). This is partly due to the lack of SME expertise and know-how and to the limited incentives to encourage technology transfer. With Malaysia attracting new high-value investments into the economy, exploring ways to enable SMEs to increase their capabilities to successfully establish linkages with these MNCs could play a crucially positive role in realizing optimal gains from these increased foreign investments.

RECOMMENDATION 8: Foster linkages between SMEs and innovators (MNCs and academia) to encourage and incentivize innovation by SMEs.

Malaysia's SME development program portfolio also contains only a limited number of programs that facilitate linkages between SMEs and academia. To realize the potential benefits of such linkages, direct and indirect incentives could be increased to encourage collaboration, with measurable targets for both the SMEs and academic institutions to attain through the linkage. So far, collaborative linkages between local SMEs and foreign or large firms have been limited. Customizing existing supplier or industrial linkages programs to facilitate improved SME capabilities would help to increase the potential linkages between SMEs and MNCs. In response to the current crisis, the government has also initiated an online portal platform, MyAssist MSME, which offers business advisory and business matching services. It would be useful to conduct a full evaluation to determine the extent to which programs that are intended to increase SME capabilities through skills upgrading and linkages with large firms (both Government Linked Corporations, or GLCs, and Multi-National Corporations) achieve their intended objectives, so as to provide inputs to improve their design and implementation.

Introduction

Malaysia's small and medium enterprises (SMEs) face increasingly significant challenges in terms of achieving increased productivity. These SMEs constitute the majority of all Malaysian enterprises, contributing to 48 percent of national employment; 38.2 percent of overall gross domestic product (GDP); and 13.5 percent of the nation's overall exports (DOSM 2021). Overall, Malaysia's average labor productivity growth rate has been declining in recent years, going down from 3.8 percent in the 1990s to 2.4 percent in more recent years (2011 – 2017). This decline is intensifying the challenges Malaysia faces in its efforts to achieve its aspirations of becoming a high-income nation. With its significant role within and contribution to Malaysia's economy, the SME sector will have to achieve higher levels of productivity and performance for these aspirations to be achieved. The COVID-19 crisis has undoubtedly had particularly adverse impacts on SMEs in terms of their productivity, performance, and survivability. In addition, compared to larger enterprises, SMEs also tend to have relatively weak technological and innovative capabilities, which can constrain their ability to integrate into global value chains (GVCs). Thus, there is an urgent need for SMEs to adapt and to become more innovative, both to achieve higher levels of resilience, to increase their productivity, and subsequently to improve their performance organically.

In the context of the serious fiscal challenges related to the current COVID-19 crisis, there is an urgent need to recalibrate public support towards SMEs so that Malaysia's post-pandemic recovery can be more effectively driven by the private sector. Prior to the crisis, the combined impact of a persistent decline in revenue and increasing committed expenditures had already narrowed the government's fiscal space. Increased public expenditure in response to the pandemic has exacerbated this situation. With the current level of available resources, the medium-term focus of fiscal policy will need to be on rebuilding fiscal buffers through fiscal consolidation, thus limiting the scope for measures to promote medium-term growth through fiscal policy.

In this context, the overall objective of this study is to analyze the composition of policies in order to identify opportunities to decrease redundancies and to increase efficiencies by ensuring that the provision of public support to promote the development of the SME sector effectively addresses these enterprises' most pressing needs. Over the decades, the Malaysian government has introduced numerous instruments and programs to support the growth and development of the SME sector, with frequent revisions and reforms over the years. Increasingly, the Malaysian government's recent policy initiatives have focused on improving firm performance and productivity, as evidenced by the policies introduced in its recent Malaysia Plans and in the National Entrepreneurship Policy 2030 issued by the Ministry of Entrepreneur Development and Cooperatives (MEDAC). Initiated at the request of the Government to inform policymaking related to the SME sector, this study aims to assist policy makers by providing inputs to enable them to effectively recalibrate support programs to better meet the needs of SMEs. For this study, 275 different SME and entrepreneurship support programs and instruments have been meticulously mapped into a matrix containing detailed information regarding each of these programs. Finally, to identify opportunities to improve the efficiency of the policy mix, a redundancy analysis has been conducted to investigate potential redundancies in the policy mix.

The study is structured into three distinct sections. The first section provides a country needs assessment that analyzes the local framework conditions that determine the needs of SMEs, with a view to facilitating productivity-led growth in Malaysia. The second section provides a thorough review of the SME policy framework and accompanying SME program policy mix in Malaysia. The study concludes by identifying key policy directions and recommendations to improve the coherence of Malaysia's policy and program mix, and to support and inform the government's efforts to achieve innovation-led productivity growth within the country's SME sector.

CHAPTER 1

Country Economic Assessment

This chapter aims to identify the principal drivers of economic performance in Malaysia, with a particular focus on the constraints on SME development. The analysis in this section covers the following areas: a) economic trends, particularly as they relate to SME performance and trade performance; b) firm performance and productivity differences across firms; c) innovation, including investments in research and development and technology/digital adoption; and d) market and institutional factors that influence resource allocation and firm productivity, including factors such as labor markets, business environment, and competition policy.

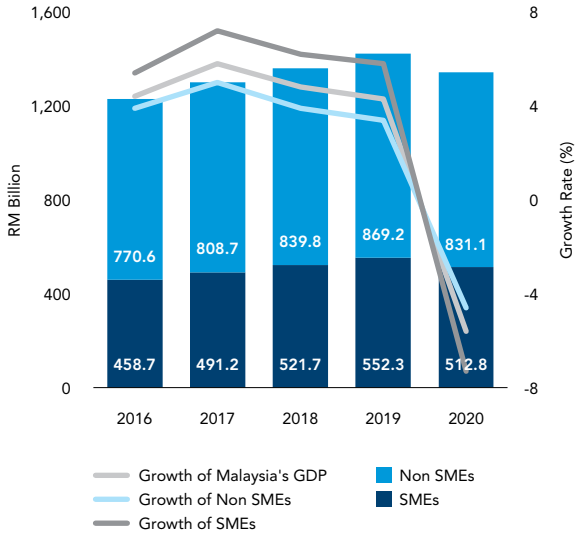
Economic Trends and Trade Performance in Malaysia

SME Performance

Making up the majority of Malaysia's firms, SMEs play a vital role in the country's economy, contributing significantly to employment, GDP, and exports. Accounting for approximately 97.2 percent of business establishments in Malaysia, SMEs (including microenterprises) contribute to 48 percent of national employment; 38.2 percent of overall GDP; and 13.5 percent of the nation's overall exports (DOSM 2021).

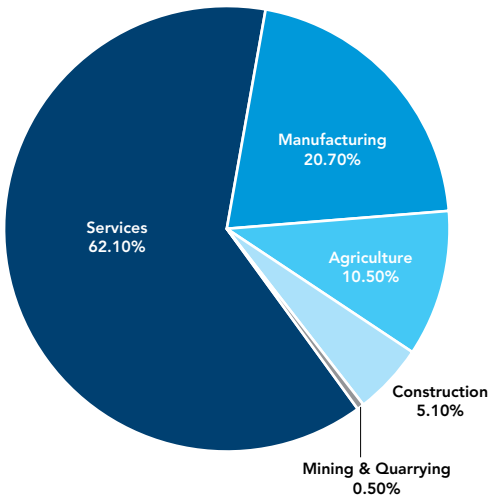
Prior to 2020, Malaysia's SMEs recorded steady growth. According to the most recently available statistics, SMEs recorded a growth rate of 6.2 percent in 2018 and of 5.8 percent in 2019. These growth rates are significantly higher than both the national GDP growth rate and for non-SMEs (see Figure 1). However, with the drastic impact of the COVID-19 pandemic in 2020, Malaysia experienced a significant contraction in its GDP growth rate, with a disproportionately high impact on SMEs. In 2020, the contribution of the SME sector to GDP contracted by 7.3 percent, higher than both the rate of contraction to overall GDP (-5.6 percent) and to non-SMEs contribution to GDP (-4.6 percent).

Figure 1: Value Added and Annual Percentage Change



Source: Department of Statistics Malaysia

Figure 2: SME GDP Distribution by Sector in 2020



Source: Department of Statistics Malaysia

BOX 1

SME Definition and Composition in Malaysia

SMEs can be defined as non-subsidiary, independent firms that employ fewer than a given number of employees and/or that have a sales turnover of less than a specified amount. These numbers may vary across different countries. For instance, the United States defines SMEs as firms with fewer than 500 employees, while the European Union defines them as those with less than 250 employees.

In Malaysia, SMEs are further divided into three categories, these being microenterprises, small enterprises and medium enterprises. There are also specific additional criteria for different sectors, particularly the manufacturing sectors and the services and other sectors. The definition of SMEs in Malaysia is outlined in the table below.

Table 1: Definition of SMEs in Malaysia

Category	Microenterprise	Small Enterprise	Medium Enterprise
Manufacturing	Sales turnover of less than RM300,000 ***OR*** employees of less than 5	Sales turnover from RM300,000 to RM15 million ***OR*** employees from 5 to 75	Sales turnover from RM15 million to RM50 million ***OR*** employees from 75 to 200
Services and Other Sectors		Sales turnover from RM300,000 to RM15 million ***OR*** employees from 5 to 30	Sales turnover from RM3 million to RM20 million ***OR*** employees from 30 to 75

Additionally, women-owned businesses are defined as those in which either at least 51 percent of the equity is held by women or if the Chief Executive Officer (CEO)/Managing Director is a woman who owns at least 10 percent of the equity. Recent statistics show that around 20.6 percent of SMEs in Malaysia fall into this category.

From the latest Malaysia Statistical Business Register (produced by DOSM) in 2020, the composition and distribution of SMEs by size and sectors are as below:

Table 2: Composition of SMEs by size in 2020

Size	Number of Establishments	Percentage Share (%)
Microenterprises	903,174	78.4
Small	229,876	20
Medium	18,289	1.6
Total	**1,151,339**	**100**

Table 3: Distribution of SMEs by sectors in 2020

Size	Number of Establishments	Percentage Share (%)
Mining and Quarrying	3,490	0.3
Agriculture	19,130	1.7
Construction	58,439	5.1
Manufacturing	85,637	7.4
Services	984,643	85.5
Total	**1,151,339**	**100**

Source: SME Corp and Department of Statistics Malaysia

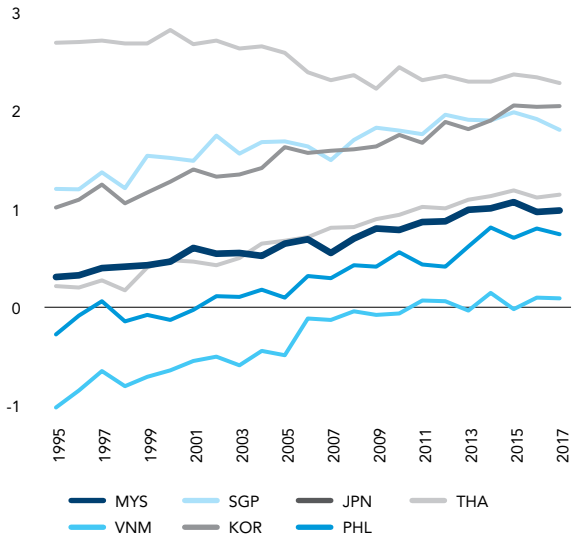
Of the total share of the SME sector's contribution to GDP, the greatest proportion derives from the services sectors, followed by the manufacturing sector. The services sector is responsible for the lion's share of the contribution, amounting to 62.1 percent, with the manufacturing sector accounting for 20.70 percent (see Figure 2). The construction and the mining and quarrying sectors contribute to relatively small proportions of SME GDP, at 5.1 percent and 0.5 percent respectively, reflecting the fact that these sectors are dominated by larger firms. Additionally, prior to 2020, SMEs in the services sector recorded the most rapid rates of growth in SME GDP, while those in other sectors recorded a slight deceleration in growth (DOSM 2021). In 2020, however, the sectors that experienced the most severe decline were the construction and services sectors, contracting by 15.4 percent and 9.2 percent respectively.

While prior to 2020, the SME sector's contribution to employment had been growing at a relatively rapid rate compared to other sectors, in 2020, this sector recorded the most significant decline in employment. The most recent statistics from DOSM show that the growth in SMEs' contribution to employment prior to 2020 was driven largely by the services and manufacturing sector. However, in 2020, total employment in SMEs shrunk by -0.9 percent, in contrast to non-SMEs, in which employment grew by about 0.5 percent, resulting in a decline to overall employment in Malaysia by 0.2 percent. This resulted in a decline in the total share of SMEs contribution to employment from 48.4 percent in 2019 to 48 percent in 2020.

Trade Performance

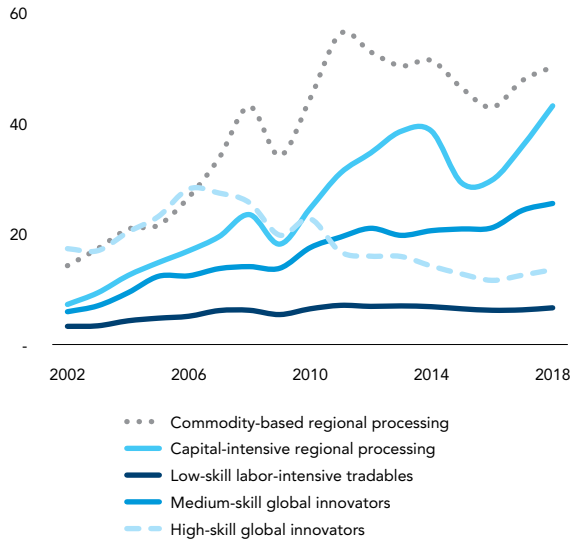
The Malaysian economy shows a moderate degree of economic complexity, despite export growth in most categories of goods.[6] In the ASEAN region, Malaysia has a relatively complex export mix, although is outperformed by other advanced countries in the East Asia and Pacific (EAP) region such as Korea, Japan, and Singapore (see Figure 3). At the same time, the degree of Malaysia's economic complexity has remained fairly stagnant over the past two decades, with some decline in the late 2000s and only slow growth and slight improvements over the past ten years. This has resulted in Malaysia being overtaken by regional peers such as China and Thailand in recent years. This can be attributed to the nature and composition of Malaysia's export basket. While Malaysia's manufactured exports have increased in most categories of goods, they have faced declines in recent years in high-skill global innovator products (see Figure 4), for which exports have declined since reaching a peak in 2006, allowing for other nations to catch up and overtake in terms of economic complexity.

Figure 3: Economic Complexity Scores (2000 - 2017) (SITC Classification)



Source: Atlas of Economic Complexity by the Growth Lab at Harvard University

Figure 4: Malaysia's manufactured exports by category, US$ billion



Source: World Bank staff calculations based on Comtrade data

Malaysia's export activities also reflect a high degree of integration into GVCs, with the nation remaining fully committed to upgrading its position within these chains over the past few years.[7] Malaysia's high degree of trade openness has facilitated the integrations within the GVCs since the 1990s, particularly in the downstream stages (Han and Hwa 2017). Linkages in the value chains can be assessed by an examination of the nation's trade in terms of value-added.[8] With Malaysia importing significant foreign inputs to produce its exports, the foreign value-added of Malaysia's exports stood at 43 percent of total gross exports. While this is still high relative to most comparators, there has been a decline in recent years (see Figure 5).

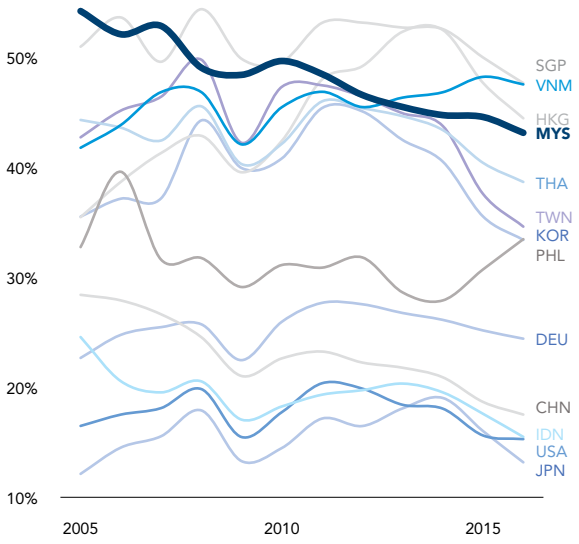
6 The economic complexity index is a measure of the knowledge in a society as expressed in the products it makes. It is calculated based on the diversity of exports a country produces and their ubiquity, or the number of the countries able to produce them (and those countries' complexity). Countries that can sustain a diverse range of productive know-how, including sophisticated, unique know-how, are found to be able to produce a wide diversity of goods, including complex products that few other countries can make.

7 Boosting Competitiveness Chapter in the World Bank Report: "Aiming High- Navigating the next stage of Malaysia's development" (World Bank 2021a).

8 Foreign value added in Malaysia's gross export is related to backward linkages in the GVCs whereas the domestic value added relates to the forward linkages in the GVCs. Trade in value-added statistics can give a better representation of the direct value added embodied in a country's exports by distinguishing the value of domestic and foreign inputs (goods and services) in a country's gross exports (for more details, see http://oe.cd/tiva)

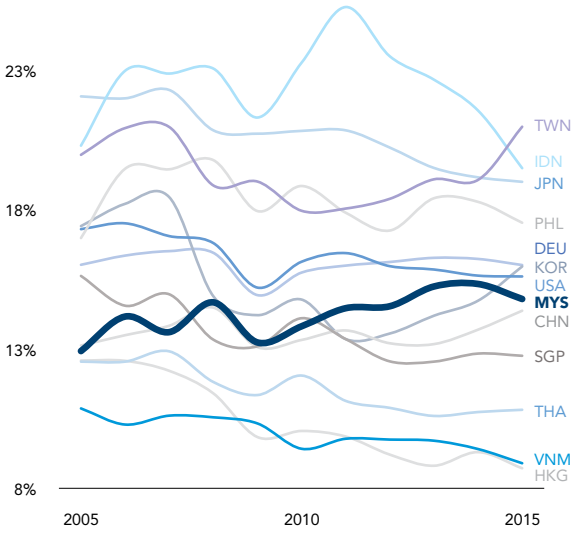
This high level may indicate positioning toward the end of value chains, such as assembly tasks.[9] In Malaysia, industrial activities, particularly those of most local firms, have tended to focus on the production of low value-added products and services (EPU 2018). At the same time, despite domestic value-added being relatively low, it has seen some recent increases (see Figure 6). As a seller of inputs for further downstream processes, Malaysia's forward linkages are relatively smaller, with domestic value-added in foreign exports as a percentage of gross exports standing at 15 percent in 2016. In the case of Malaysia, the pronounced decrease may also reflect the gradual strengthening of domestic suppliers and a movement away from the later stages in GVCs. Conversely, the level of Malaysia's forward linkages (which have increased slightly) places it in an intermediate position in the region (see Figure 6). This increase could be consistent with a modest movement upstream and with improvements in Malaysia's position within these GVCs.

Figure 5: Backward Linkages: Foreign Value Added as a Percentage of Gross Exports



Source: OECD TiVA Database

Figure 6: Forward Linkages: Domestic Value Added in Foreign Exports as a Share of Gross Exports

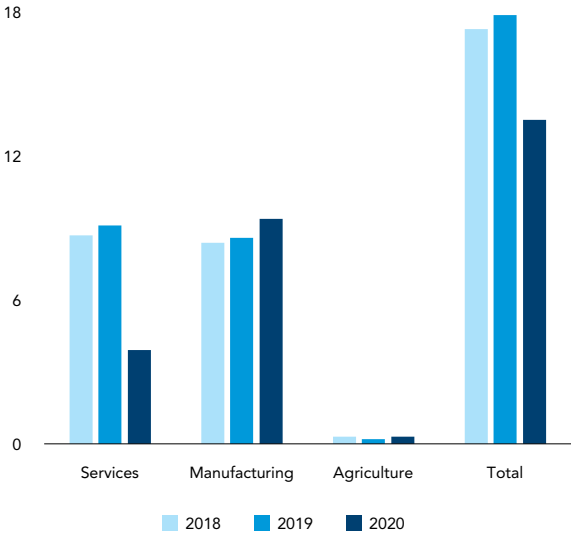


Source: OECD TiVA Database

In the context of the COVID-19 pandemic, manufacturing has contributed to an increasing proportion of SME exports, with the export of services declining drastically. Recent statistics show that prior to 2020, SMEs' contribution to Malaysia's exports of goods and services was increasing, with contributions going up from 17.3 percent in 2018 to 17.9 percent of total exports in 2019 (see Figure 7). However, in 2020, the SME sector's contribution to exports shrunk to 13.5 percent of total exports. The decline in SME exports within the services sector was particularly severe, with the SME share of exports in services going down from 9.1 percent in 2019 to 3.9 percent. This is also seen by the changes in the total exports by SMEs, with declines in exports by SMEs in all sectors except for agriculture (see Figure 8). Again, the services sector was particularly severely affected, with total exports for SMEs in this sector plunging by 62 percent, compared to a decline of 3.6 percent for SME exports in the manufacturing sector.

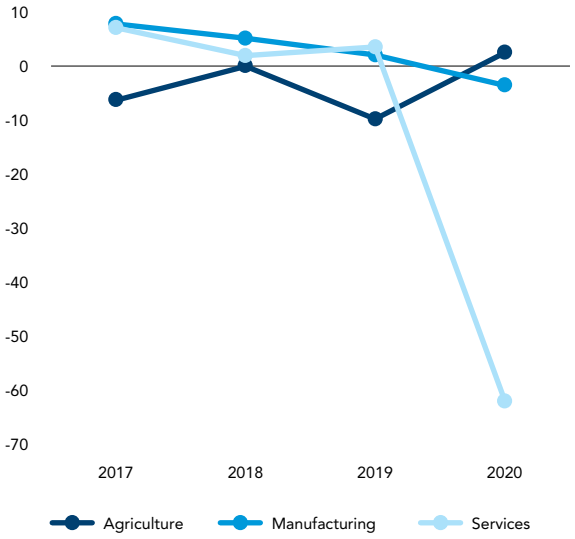
9 High backward linkages can also reflect other factors, such as a small country size and easy access to foreign suppliers, which is likely to be the driving factor in the cases of Hong Kong and Singapore.

Figure 7: SME Percentage Share of Malaysia's Export by Sector



Source: Department of Statistics Malaysia

Figure 8: Annual Percentage Change of SME Exports by Sector

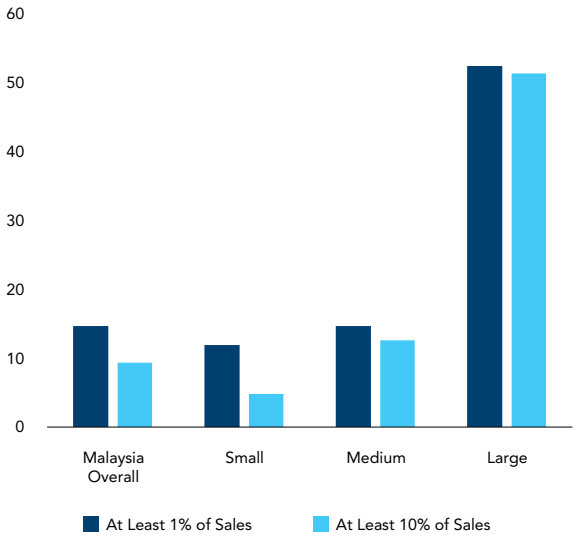


Source: Department of Statistics Malaysia

Despite Malaysia's deep integration within GVCs, its exports are dominated by large firms, with SMEs achieving relatively low levels of integration within these GVCs. It is estimated that less than 5 percent of small businesses and less than 15 percent of medium businesses in Malaysia have exports that account for at least 10 percent of their overall sales/revenue in Malaysia. By contrast, around 50 percent of large businesses have exports that reach these levels (see Figure 9).[10] Furthermore, the proportion of small Malaysian firms that export their products is low relative to that of some relevant comparators. On average, in the EAP region, approximately 10.3 percent of small firms engage directly or indirectly in exporting, with the figure for the Europe and Central Asia region standing at approximately 15.8 percent (see Figure 10). Compared to a number of other countries in the EAP region and to countries in the same income bracket, particularly China, Indonesia, and Vietnam, Malaysia's small firms record relatively low levels of exports.

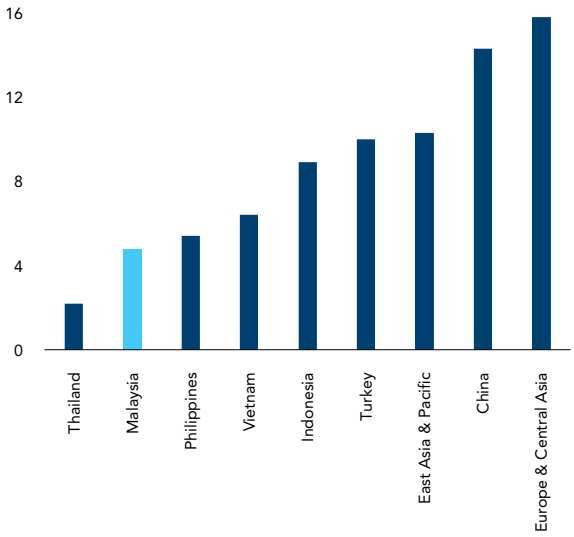
10 The size classifications used in the World Bank Enterprise Surveys are different from the definition of SMEs established for Malaysia. The classifications used in the World Bank Enterprise Surveys are standardized across other countries in order to enable cross-country comparisons and benchmarking exercises.

Figure 9: Proportions of Firms that Export their Goods or Services by Size



Source: World Bank Enterprise Surveys

Figure 10: Proportions of Small Firms Exporting Directly or Indirectly (at least 10% of sales)



Source: World Bank Enterprise Surveys

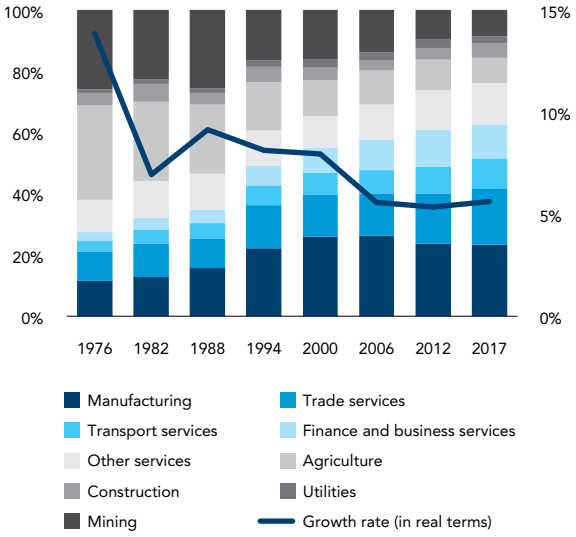
Productivity and Performance

With Malaysia's traditional drivers of economic growth having slowed, productivity growth has become increasingly important. While Malaysia has recorded consistently high GDP growth rates over recent years, structural constraints on this growth have begun to emerge. In particular, supply limitations in the natural resources sectors, together with concerns regarding the scale and sustainability of Malaysia's debt, have reduced the pace of capital accumulation. In addition, demographic trends associated with an aging population are slowing the growth of the labor force, which must also adapt to the changing nature of work.

While Malaysia's total value-added has grown steadily with the growth and expansion of its economy, the rate of growth has been declining, with its labor productivity remaining far below that of high-income economies. Based on an examination of the World Bank's Global Productivity database, while the estimates for Malaysia's total value-added have increased in recent years, there has been a consistent decline in annual growth rates, with these rates reaching their lowest range in more recent years (see Figure 11). Reflecting the trends alluded to earlier, estimates for total value-added also show a shift away from manufacturing towards the services sector. Additionally, labor productivity has exhibited growth over the past two decades. While significantly surpassing the levels of labor productivity recorded by other ASEAN countries (excluding Singapore), Malaysia is still playing catch-up with higher income and OECD countries (see Figure 12).[11] Aggregate productivity grew at its fastest rates in the 1990s (at an average of 3.8 percent per annum), when Malaysia was experiencing particularly rapid rates of economic growth in the years prior to the advent of the Asian Financial Crisis. In more recent periods (2011 to 2017), labor productivity has fallen to an annual average growth rate of 2.44 percent.[12]

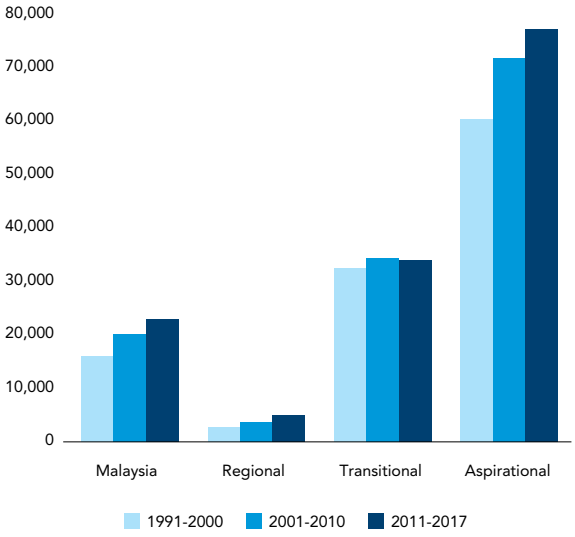
11 The same can be said when assessing the labor productivity in a single year instead of aggregating time periods.
12 Overall labor productivity growth rates are consistent with the rates produced by DOSM.

Figure 11: Malaysia's Total Value-Added Composition (Percentage)



Source: World Bank Global Productivity database

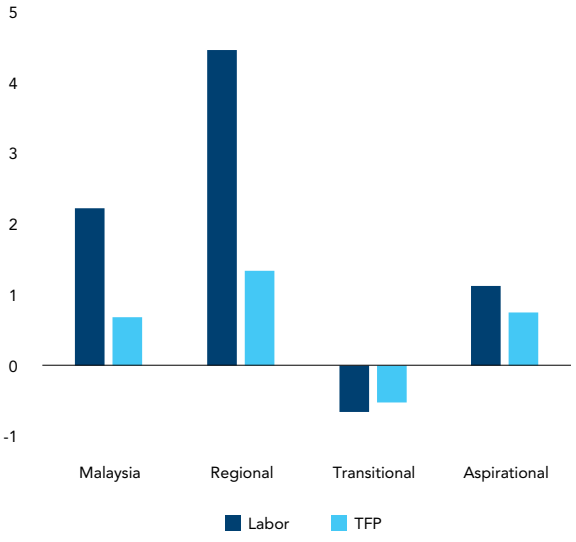
Figure 12: Labor Productivity (GPD per employee in 2010 constant dollars)



Source: World Bank Global Productivity database

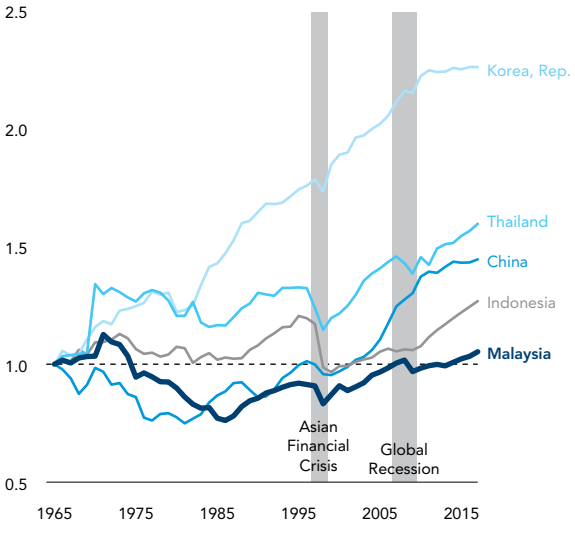
The deceleration in the growth of labor and total factor productivity (TFP) suggests that the pace of convergence of Malaysia's economy with those of the developed nations is slowing. Despite the slowdown in labor productivity growth, Malaysia's rates have shown some convergence with developed countries with relatively higher annual labor productivity growth. However, low levels of total factor productivity growth relative to regional and high-income economies suggest that the pace of convergence is slowing (see Figure 13). It also suggests that other ASEAN economies are catching up with Malaysia. Over a long period, it can also be observed that Malaysia's TFP growth has been lower than some of its peers (see Figure 14). Much of this has been attributed to growth being boosted by factor accumulation. Thus, the competitiveness of the Malaysian

Figure 13: Annual Growth in Labor Productivity and Total Factor Productivity (Percent)



Source: World Bank Global Productivity dataset

Figure 14: TFP at Constant National Prices (1960 = 1)

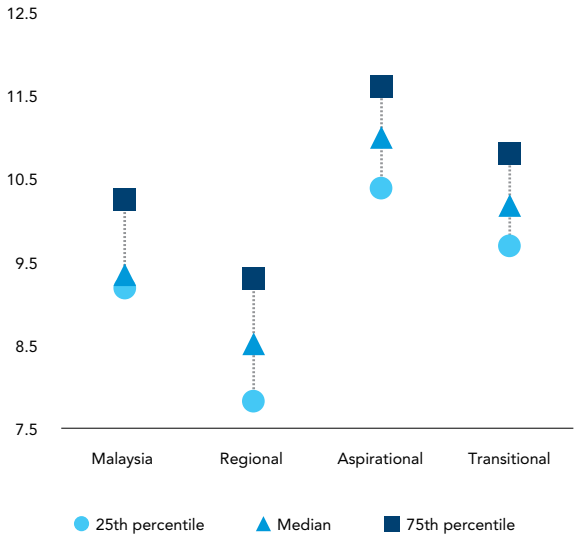


Source: World Bank staff calculations based on Penn World Tables

economy will be increasingly driven by innovation-led growth to increase productivity and foster an efficient allocation of resources (World Bank 2018).

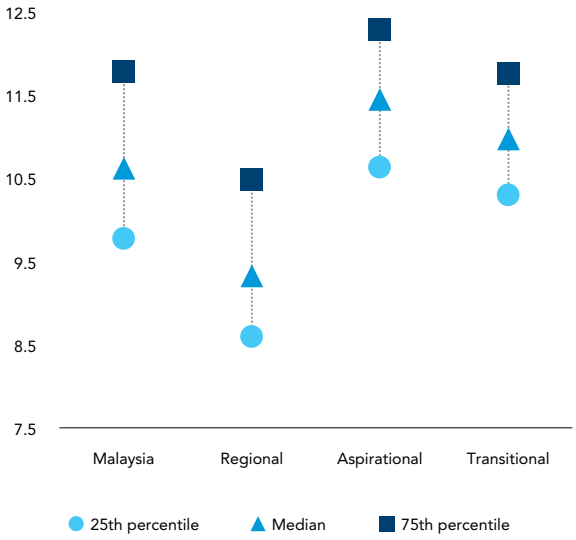
Despite the growth in aggregate labor productivity, firm-level data shows that Malaysian firms' levels of labor productivity lag behind aspirational and transitional countries, with varying productivity gaps across different firm sizes. Looking at Malaysian firms across both the manufacturing and services sectors, while the level of labor productivity of Malaysian firms exceeds those of its regional comparators in the ASEAN

Figure 15: Distribution of Firm-level added value per employee (2009 US$, Log) in Manufacturing



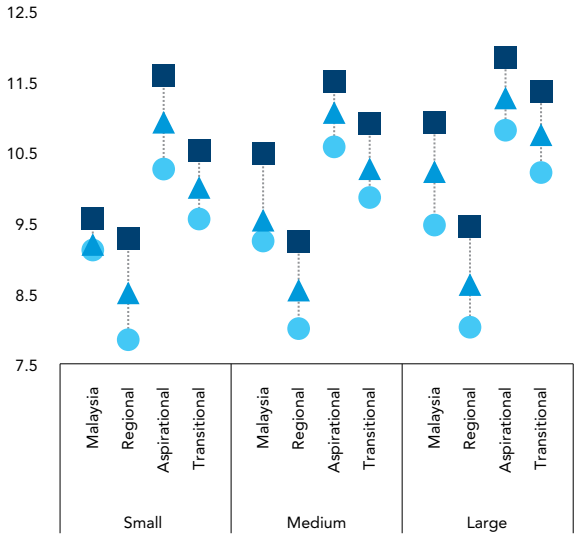
Source: World Bank (2020) 'Malaysia – Productivity and Investment Climate Survey (PICS 3)'

Figure 16: Distribution of Firm-level added value per employee (2009 US$, Log) in Services



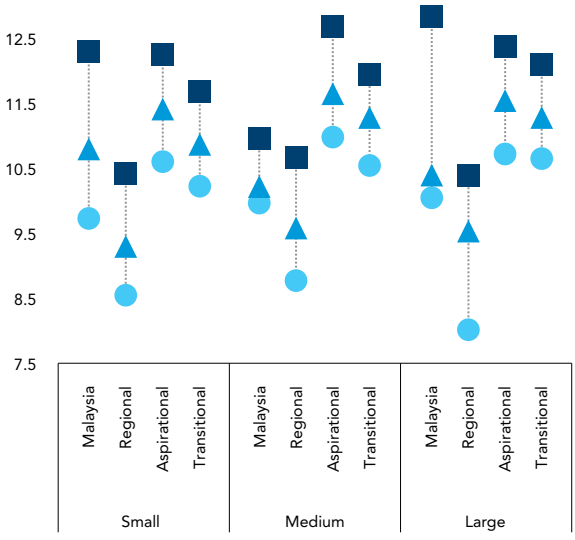
Source: World Bank (2020) 'Malaysia – Productivity and Investment Climate Survey (PICS 3)'

Figure 17: Distribution of Firm-level added value per employee (2009 US$, Log) in Manufacturing by Size

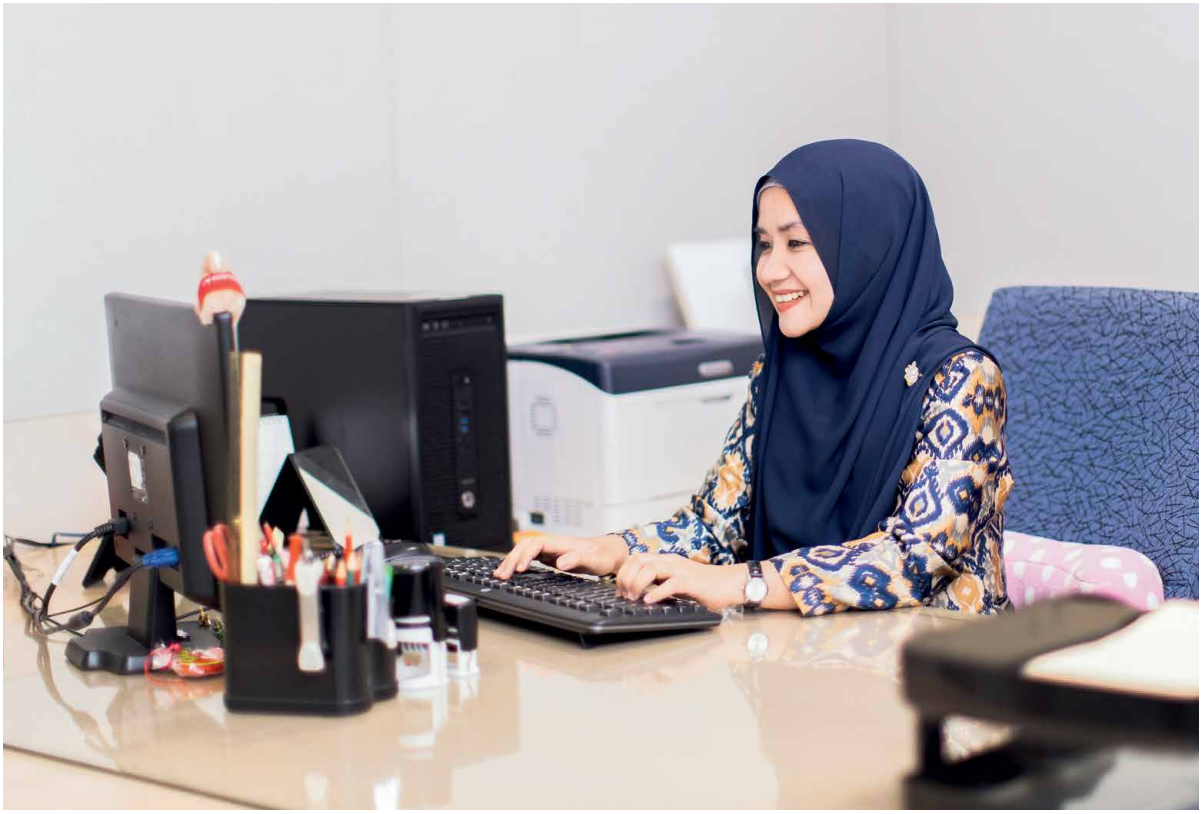


Source: World Bank (2020) 'Malaysia – Productivity and Investment Climate Survey (PICS 3)'

Figure 18: Distribution of Firm-level added value per employee (2009 US$, Log) in Services by Size



Source: World Bank (2020) 'Malaysia – Productivity and Investment Climate Survey (PICS 3)'

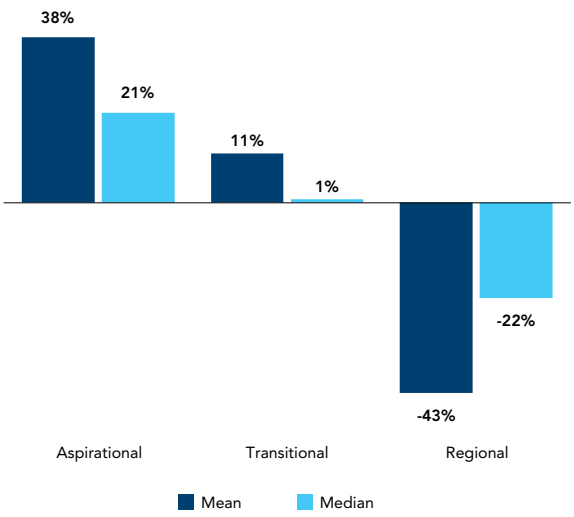


region, it lags aspirational and transitional countries, with relatively wide gaps in the manufacturing sector (see Figure 15 and Figure 16). Assessing levels of labor productivity by firm size reveal similar patterns. The labor productivity gap is wider for smaller manufacturing firms, with the gap narrowing as the size of the firms increases (see Figure 17). On the other hand, performance in terms of labor productivity is more dispersed among firms in the services sector. Smaller Malaysian firms in the services sector displayed slightly higher levels of labor productivity compared to medium and large firms, but with a wider distribution of productivity levels (see Figure 18).

Firm-level TFP data suggest that Malaysian TFP lags behind comparators, with variations across firm size and exporting status.[13] Malaysia's TFP level is lower than in the aspirational and transitional comparator country groups (see Figure 19). A further breakdown by firm size suggests that this lagging pattern is driven by the relatively poor performance of small firms, with medium and large firms being much closer to those in the transitional and aspirational groups (see Figure 20). The typical mismatch between high aggregate employment and lower productivity and output has traditionally been a constraint specific to SMEs, related to their small size and inexperience, which prevents them from achieving economies of scale and access to strategic resources. The similarities and variations in Malaysia's TFP compared to the transitional group appear to be more driven by the exporting status and foreign ownership of firms. Exporting firms tend to record higher levels of TFP, with TFP being positively correlated with the share of exported sales among manufacturing firms (see Figure 21). This echoes the conclusions of the TFP analysis conducted in recent years for Malaysia (World Bank 2018). The same could be said about the relationship between foreign ownership of firms and firms' TFP levels (see Figure 22).

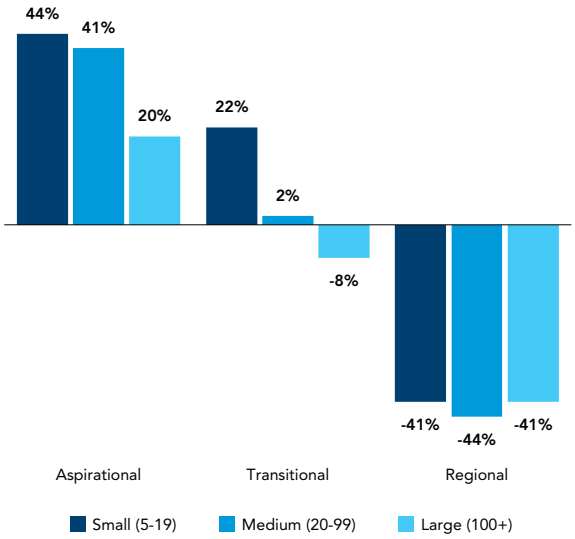
13 The firm level TFP analysis applied only to manufacturing firms.

Figure 19: Relative TFP of Comparator Groups to Malaysia



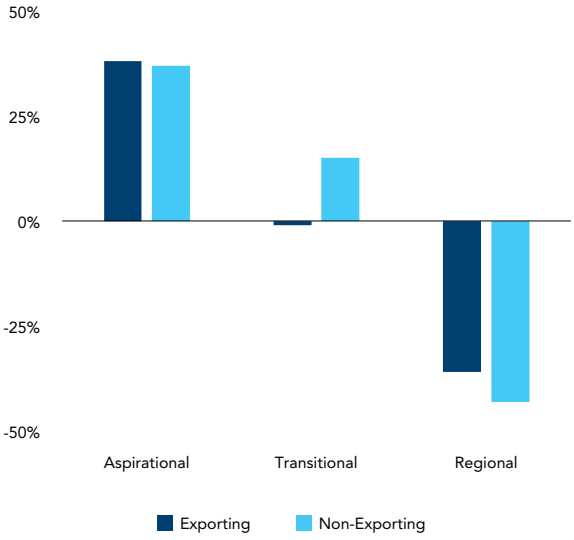
Source: World Bank (2020) 'Malaysia – Productivity and Investment Climate Survey (PICS 3)'

Figure 20: Relative TFP of Comparator Groups to Malaysia by Size



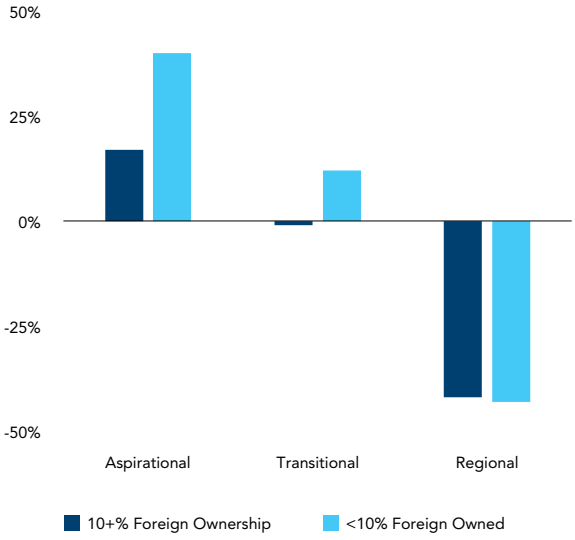
Source: World Bank (2020) 'Malaysia – Productivity and Investment Climate Survey (PICS 3)'

Figure 21: Relative TFP of Comparator Groups to Malaysia by Exporting Status



Source: World Bank (2020) 'Malaysia – Productivity and Investment Climate Survey (PICS 3)'

Figure 22: Relative TFP of Comparator Groups to Malaysia by Ownership Status



Source: World Bank (2020) 'Malaysia – Productivity and Investment Climate Survey (PICS 3)'

BOX 2

COVID-19 Impact on Productivity

Past economic crises suggested that the COVID-19 pandemic is likely to have an impact on firm-level productivity through three major channels. While the scale of the impact is hard to quantify, the impact will likely be significant. The crisis is likely to affect productivity growth by driving firms out of business; through the loss of valuable intangible assets; and through diminished productivity-enhancing investments within firms.

First, evidence from past crises suggests that the current crisis is likely to result in the exit not just of weak firms, but also of a significant number of stronger firms. More productive firms may be better able to weather the ongoing crisis by virtue of having a broader customer base, better access to finance, or hire abilities to adapt new business models. However, these advantages may not be sufficient to ensure their survival in the face of persistent low demand. The exit of good firms will mean the loss of intangible assets (such as firm-worker and supply chain relationships or management practices) that contribute positively to the achievement of higher levels of productivity and are difficult to rebuild. Unemployment could deprive the firm (if it survives) of hard-to-replace skills and reduce workers' future earnings if they are unable to employ these firm-specific skills elsewhere.

Second, fewer firms are likely to enter new and existing markets, with start-ups typically binding it hard to survive. This will have a detrimental effect on longer-term productivity growth, as start-ups help play a significant positive role in the diffusion of new technologies and business models. Across the region, new business registrations dropped in the first seven months of 2020, compared to the same period in 2019.

Third, surviving firms may face prolonged uncertainty and be saddled with debt, reducing their future ability to make productivity-enhancing investments. During past crises, firms were less likely to undertake disruptive, radical innovation, cutting back disproportionately on intangible investments in data, technology and worker training. The pandemic has led to enormous increases in firm uncertainty, dwarfing those recorded during the global financial crisis and leaving firms with increased debts and stranded assets, such as unused office and factory capacity. Firms have responded by significantly cutting expenditures on innovation, training and general management improvements, which is likely to have a significant negative impact on future productivity growth.

One bright spot is that COVID-19 has accelerated investment in digital technologies and innovation that may translate into increased productivity growth and some positive reallocation. In particular, the crisis may also be catalyzing the use of digital financial services to ensure that financial systems continue to function and to protect people in the context of the pandemic. Across 74 countries, daily downloads of fintech apps have increased by an average of 24 percent since the COVID-19 lockdown began, with a particularly high rate of increase in Asia, at around 65 percent.

However, the diffusion of new digital technologies requires governments to create a regulatory and incentive framework that encourages the development of the broadband infrastructure, competitive pricing of services, and complementary intangible investments in training and reorganization by firms.

Large and more productive firms in locations with high-quality digital infrastructure are better placed to make such investments, which can widen disparities between the best firms and the rest.

Source: World Bank East Asia and Pacific Economic Update, October 2020 (World Bank 2020c)

The Impact of the COVID-19 Pandemic on Businesses

The imposition of the nationwide Movement Control Order (MCO), and subsequently of less stringent restrictions under a Conditional Movement Control Order (CMCO) and Recovery Movement Control Order (RMCO), has had a substantial impact on business operations in Malaysia, with all sectors recording significantly lower levels of outputs. An examination of a survey of Malaysian firms enables a thorough assessment of the impact of the pandemic on firms. The COVID-19 Business Pulse Survey (BPS) is a rapid survey designed to measure the impact of COVID-19 through various channels on firms, their adjustment strategies, and their attitude towards public policy responses.[14] The analysis included in this study will focus on the main measures and indicators of businesses (a more in-depth analysis can be found in three standalone studies).[15]

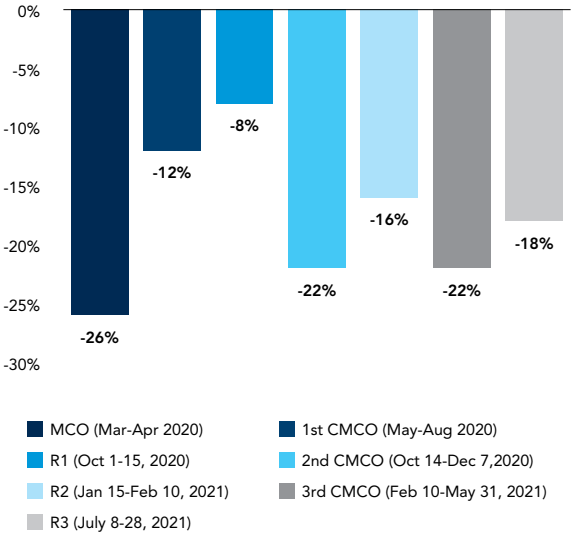
The surveys show that Malaysian firms faced disruptions from the temporary closure of businesses and from the high degree of volatility in domestic conditions. The nationwide MCO, first implemented in early 2020, resulted in disruptions for 86 percent of the surveyed firms, with these firms not being fully open during the periods for which the restrictions were imposed. The subsequent easing of restrictions under the CMCO enabled a greater proportion of businesses to be fully open, although most firms (approximately 57 percent) were only partially open during this period. The main reason provided by the survey respondents for business closure was health concerns, followed by businesses having insufficient cash to pay their costs (Kuriakose and Tran 2020). The subsequent rounds of the survey found that there were significant variations in recent operational status, with small firms being more likely to remain closed in recent months than medium or large firms (Kuriakose et. al 2021b).

On average, the respondents reported that sales revenue had decreased drastically, with only incomplete recovery since. Unsurprisingly, most businesses reported negative sales growth. On average, sales decreased by approximately 26 percent during the MCO period compared to the same period in the previous year (see Figure 23). In total, 66 percent of firms reported that during the period in question, they suffered a decrease in revenue, with 27 percent of firms reporting that they faced stagnant growth (see Figure 24). As the restrictions eased, the respondents generally reported improvements to sales revenue, with substantially fewer businesses reporting revenue loss during this period. During the less restrictive period, the average decrease in sales stood at around 12 percent, with fewer firms reporting losses in revenue as restrictions eased following the end of the first CMCO period and towards October 2020. However, the re-implementation of the CMCO resulted in a reversal of this recovery. Firms again faced drastic decreases in sales revenue, of about 22 percent during the second CMCO and of about 16 percent in early 2021, relative to levels recorded in the same periods prior to COVID-19. The third CMCO also resulted in decreases in average sales revenue back to 22 percent, but the average reduction in sales in the middle of the year (during the implementation of round three of the survey) was slightly better at 18 percent.

14 The BPS was conducted for three different rounds. The first round of the survey was conducted between 1-15 October 2020 and the subsequent rounds of the survey were conducted between 15 January to 10 February 2021 and 8-28 July 2021 respectively.

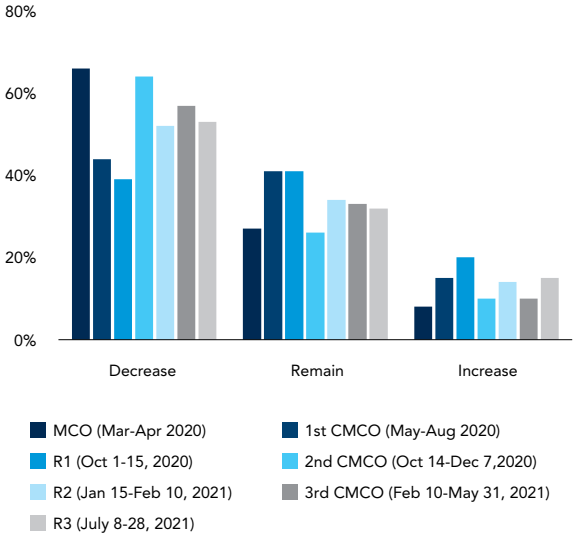
15 For more information about the BPS, please refer to Appendix 2: The Enterprise Survey and The COVID-19 Business Pulse Survey or refer to the following studies:
- Kuriakose, Smita; Tran, Trang. 2020. Impacts of COVID-19 on Firms in Malaysia, Report No. 1: Results from the First Round of COVID-19 Business Pulse Survey. World Bank, Washington, DC. © World Bank.
- Kuriakose, Smita; Tran, Trang; Ting, Kok Onn; Hebous, Sarah. 2021a. Impacts of COVID-19 on Firms in Malaysia, Report No. 2: Results from the Second Round of COVID-19 Business Pulse Survey. World Bank, Washington, DC. © World Bank.
- Kuriakose, Smita; Tran, Trang; Ting, Kok Onn; Hebous, Sarah. 2021b. Impacts of COVID-19 on Firms in Malaysia, Report No. 3: Results from the Third Round of COVID-19 Business Pulse Survey. World Bank, Washington, DC. © World Bank.

Figure 23: Average Change in Sales Revenue Relative to Same Period Pre-COVID-19 (Percentage Change)



Source: World Bank Business Pulse Survey

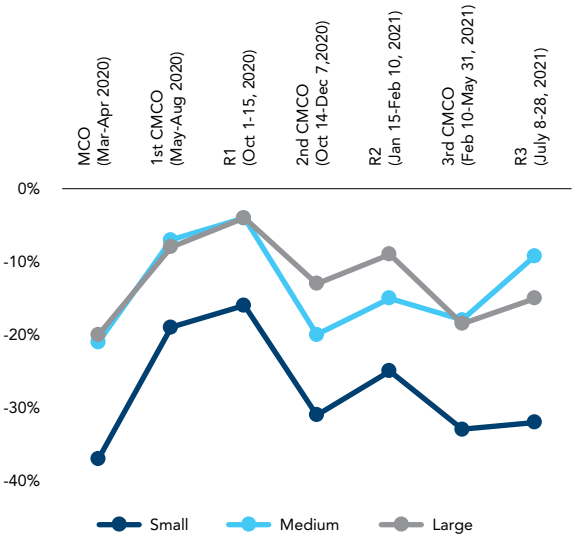
Figure 24: Changes in Sales Revenue Relative to Same Period Pre-COVID-19 (Share of Firms)



Source: World Bank Business Pulse Survey

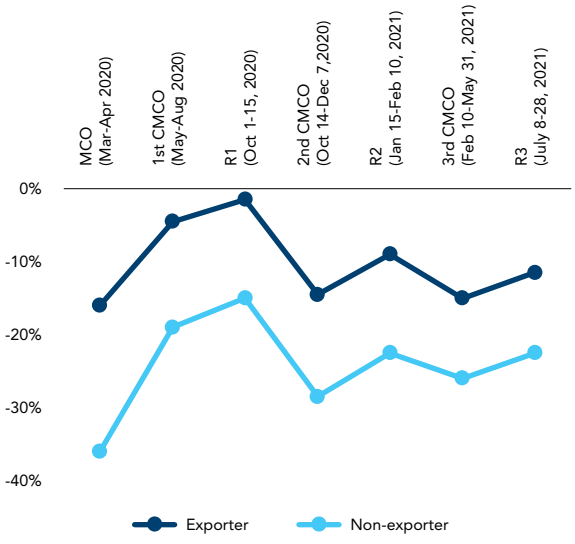
Medium and large firms and those engaged in exports have experienced a relatively more rapid recovery in sales than others. On average, small firms experienced an average decline in sales of approximately 28 percent, compared to 13 percent for medium firms and large firms (see Figure 25). Additionally, the negative impact on sales has been more pronounced in the case of non-exporting firms, with these firms experiencing an average decrease in sales of about 25 percent relative to sales during the same period prior to the COVID-19 pandemic, in contrast to exporters, for whom the figure stood at an average of 10 percent (see Figure 26). The results also showed that sectors such as tourism and construction have been severely affected in recent

Figure 25: Changes in Sales Revenue Relative to Same Period Pre-COVID-19 by Size (Percentage Change)



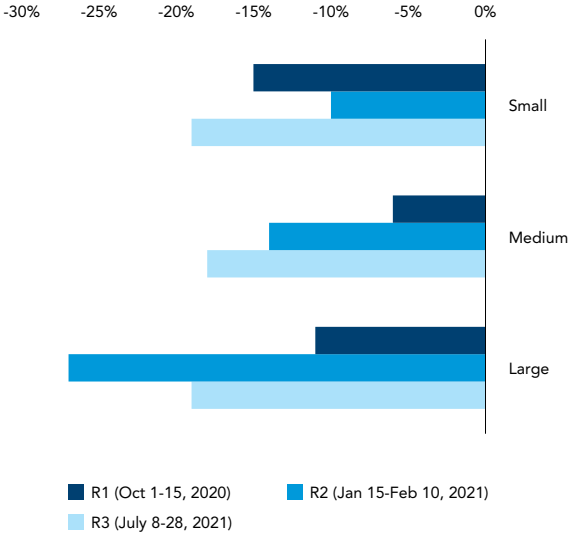
Source: World Bank Business Pulse Survey

Figure 26: Changes in Sales Revenue Relative to Same Period Pre-COVID-19 by Exporter Status (Percentage Change)



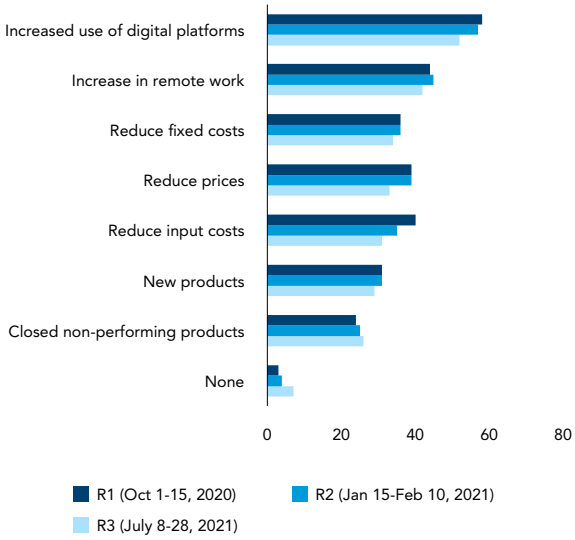
Source: World Bank Business Pulse Survey

Figure 27: Average Change in Employment Compared to Pre-Pandemic (March 2020) (Percentage Change)



Source: World Bank Business Pulse Survey

Figure 28: Strategies Implemented or Planning to Implement to Deal with COVID-19 (Share of Firms)



Source: World Bank Business Pulse Survey

periods, with these businesses recording the largest average losses in sales revenue of all sectors (Kuriakose et. al 2021).

Firms have recorded a significant employment loss since the start of the pandemic, with evidence suggesting employment churning. From the commencement of the imposition of the first MCO towards the end of 2020, more than half of the firms surveyed reported a decrease in total employment, with the average change in employment amounting to approximately -13 percent (Kuriakose and Tran 2020). On average, net employment shows a downward trend where the average employment in July 2021 is 18 percent lower than the pre-pandemic baseline, largely drive by SMEs who continue to suffer increasing losses in employment (Kuriakose et. al 2021b). Additionally, the most recent iteration of the BPS found that the average drop in employment in July 2021 for large firms is significantly lower than the previous iteration in Jan 2021 and is lower compared to that of small and medium sized firms (see Figure 27).

Firms implemented numerous adjustments mechanisms to deal with employment and business operations issues they face. Firms implemented various employment adjustment with the most common being the reduction in work hours for employees, followed by reduction in wages (Kuriakose and Tran 2020). Overall, there was a net loss in total employment across all sectors, except for automobiles and utilities, in 2020. The services sector faced the most drastic reduction in employment, while the automotive and utility sectors experienced slight net gains in employment in 2020 (ibid.).[16] On the business operations side, the most common strategy firms have adopted is to increase the use of digital platforms, followed by increasing remote work (see Figure 28). Given the nature the crisis, it is not surprising that these strategies have been the most common throughout the iterations of the BPS.

16 Net gains from the automotive and utility sectors were largely due to a smaller variance or tighter distribution of change in employment and driven by some outliers that have large net gains in employment and relatively fewer firms with net losses in employment.

The most common and severe form of disruption related to the pandemic were supply chain disruptions, with reduced orders mainly caused by decreased demand. Throughout a large part of 2020 (since the imposition of the first MCO until late 2020), 80 percent of exporting and 63 percent of non-exporting firms reported experiencing supply chain disruptions (Kuriakose and Tran 2020). Exporters also commonly faced difficulties accessing finance (59 percent of firms) while non-exporters faced more significant issues related to a decrease in demand in the local markets (61 percent of firms). Further analysis of firms' financial standings also suggests that the median firm has only two months of cashflow available before it runs into cashflow shortages. On the demand side, the drastic decrease in demand across all firms is attributed to the significant reduction in orders for the goods and services of the firms, with 46 percent of all firms reporting such issues.

BOX 3

COVID-19 SME Economic Stimulus Packages

The COVID-19 crisis has disproportionately impacted both individuals and households in vulnerable groups and smaller businesses, which includes informal entrepreneurs, microenterprises and SMEs. Since late March 2020, the Malaysian government has announced various economic stimulus packages that are intended to assist vulnerable households and SMEs across Malaysia to counter the economic impact of the COVID-19 pandemic. Packages that aims to assist SMEs were part of multiple rounds of economic stimulus, namely the *Prihatin*, *Prihatin SME Plus*, *Penjana*, *Kita Prihatin*, *Permai*, *Pemerkasa*, *Pemerkasa Plus* and *Pemulih* packages.

Prihatin and *Prihatin SME Plus* Assistance Packages

Early economic response actions and the various rounds of stimulus packages were intended to alleviate the immediate impact of the pandemic on the tourism and hospitality sectors. These measures were followed by the central bank's decision to lower the policy rate, together with the introduction of new financing facilities for SMEs through facilities established by commercial banks to provide special relief funding. On March 27, 2020, the government announced its intention to provide a substantial stimulus package, to a total value of RM250 billion (approximately US$ 62 billion), with approximately two-fifths of these funds intended to support small businesses. BNM also issued a directive to all banks to grant an automatic six-month moratorium for all loans and financing repayments, effective from April 1 to September 30, 2020, to provide relief to borrowers that met the specified criteria established by BNM. Additionally, the government announced its intention to provide the *Prihatin SME Plus* package on April 6, 2020, to an additional value of RM10 billion (approx. US$ 2.5 billion). Some of the support measures contained within these packages included the following:

Wage Subsidies and Financial Support to Employees: Wage subsidies to a total value of RM13.8 billion (approx. US$ 3.4 billion) were to be provided to all companies with employees earning a monthly salary to a value less than RM4,000 (US$ 987), with the rate of the wage subsidy varying according to the number of employees on the recipient firm's payroll.

Moratoriums or Payment Deferments: The six-month moratorium offered by financial institutions and banks provided the option to convert credit card balances into a term loan or financing. The moratorium was also available to SMEs that were recipients of loans from government agencies

or cooperatives. Additionally, tax-deferred payments on loans by businesses affected by the tourism sector were made available for six months, with the suspension of income tax installment payments for all SMEs for a three-month period commencing from April 1, 2020.

Premises Support: A six-month rental exemption was provided for all federal government-owned premises (including those owned by government agencies and statutory bodies). For premises owned by government-linked companies, SME retail traders were able to apply for rental exemption or discounts. Additionally, owners of privately-owned premises were encouraged to reduce rental rates to provide relief for SMEs through the provision of additional tax deductions equivalent to the value of the rent reduction for the period from April until June 2020.

Financial Support, Funding and Access to Finance: A wide range of forms of financial support and funding facilities were introduced to benefit SMEs. Each form of financial support targeted different beneficiaries and had different objectives. The most important of these support programs included the *Prihatin* Special Grant and the BNM's Special Relief Facilities. Additionally, government agencies and companies such as the Credit Guarantee Company (CGC), TEKUN Nasional, Malaysia Digital Economy Corporation, Human Resource Development Fund also provided some form of financial support for SMEs. The support provided through these programs largely took the form of credit facilities and credit guarantees, with some of them containing explicit goals related to training employees or increasing digital uptake.

Penjana and *Kita Prihatin* Assistance Packages

On June 5, 2020, the government announced its intention to implement an additional economic stimulus package to supplement its previous allocation of RM260 billion. The *Penjana* Stimulus Package, for which RM35 billion (approx. US$ 8.6 billion) was allocated, provided an array of tax incentives, financial support for businesses, and wage subsidies. Tax incentives provided under the *Penjana* package covered a variety of sectors and were intended to reinvigorate investment, to encourage the establishment of new businesses, and to attract foreign investments. In addition, substantial tax incentives were proposed to support the manufacturing sectors by attracting foreign investments, with an income tax rebate to an annual value of up to RM20,000 introduced for SMEs incorporated between July 1, 2020 and December 31, 2020, with the intention of supporting the establishment of new businesses. The tax relief measures provided to businesses that reduced or waived rental that were introduced under the previous stimulus packages were also extended until September 2020. Additionally, numerous tax incentives were introduced to benefit businesses in the tourism and real estate sectors and to support flexible work arrangements, the purchase of passenger cars, and relief for COVID-19 related expenses.

In addition, the new package enhanced assistance for businesses, especially for SMEs and microenterprises, through a further extension of wage subsidies and through the additional provisioning of financing for SMEs. The government also continued to support SMEs endeavoring to digitalize their operations or automate their businesses through grants provided through three programs, as follows: 1) SME Digitalization Matching Grant; 2) SME Technology Transformation Fund and 3) the Smart Automation Grant. The government also established new financing facilities for SMEs in the tourism sector to enable them to better adapt to the 'new normal' conditions and to remain sustainable. Additionally, the SME Bank was to provide liquidity support to contractors who were awarded projects under the previous stimulus packages through the SME Go-Scheme. Micro-credit financing schemes were also introduced to support the agricultural industry, particularly agropreneurs.

In September, the government announced yet another round of stimulus packages, to a value of an additional RM10 billion (approx. US$ 2.5 billion), with this latest package called *Kita Prihatin*. This package was intended to extend the benefits provided under the previous packages, including through extensions to the wage subsidy program. At the same time, the new package also included one-off financial assistance to provide RM3,000 several selected SMEs and microenterprises that had not received similar grants at earlier stages. A large share of this package (RM7 billion/approx. US$ 1.7 billion) was allocated for the provision of cash transfers to benefit B40 and M40 households.

Permai Assistance Package

In late 2020 and early 2021, Malaysia experienced a significant increase in the number of COVID-19 cases across the nation, resulting in the reintroduction of lockdowns in most states. As a result of the economic impact of these new lockdowns, another stimulus package was introduced in the middle of January 2021 amounting to RM15 billion (approx. US$ 3.7 billion).

Most of the previous support initiatives towards businesses were continued. The wage subsidy programs were also continued with an additional allocation of RM1 billion, along with the relaxation of the conditions for the national employment insurance program for those who lost their jobs. For SMEs, the government expanded the previous *Prihatin* grant assistance to cover 500,000 SMEs in the states under lockdown with a payment of RM1,000 (approx. US$ 250) each, while 300,000 SMEs in other states would receive RM500 (approx. US$ 123) each. Prior assistance such as certain tax deduction and financing through soft loans by a few financial institutions were also expanded.

Pemerkasa, *Pemerkasa Plus* and *Pemulih* Packages

Towards the end of Q1 2021 and in the middle of 2021, the Malaysian government announced additional stimulus packages to help in the recovery of the economy. The *Pemerkasa* (March 2021) and *Pemerkasa Plus* (end of May 2021) packages amounted to a combined value of RM60 billion for the whole economy. Some of the highlights of the packages for SMEs include the provision of further funding towards micro-credit facilities (RM500 million for the former and RM1.5 billion for the latter packages) at a low financing rate of 3 percent. Additionally, the subsequent wage subsidy program was extended (RM700 million for *Pemerkasa* and an additional RM1.5 billion through *Pemerkasa Plus*). Furthermore, additional funding and grants were provided to SMEs through various targeted relief and recovery facilities. Moratoriums were also extended for SMEs that were not able to operate during the periods of increased restrictions.

The *Pemulih* package was introduced by the government in late June 2021 worth RM150 billion. The large package was accelerate the recovery of the Malaysian economy, further support individuals and households badly affected over the past year and to further support the public health and immunization efforts in the country. For SMEs, the *Pemulih* packages provided further grants to micro SMEs, extension of wage subsidies, as well as extending some targeted moratoriums.

Source: SME Corp, Bank Negara Malaysia, Malaysian Prime Minister's Office and Ministry of Finance.
Note: This is not comprehensive. Readers can refer to the sources for more information.

Innovation Performance and Technological Adoption

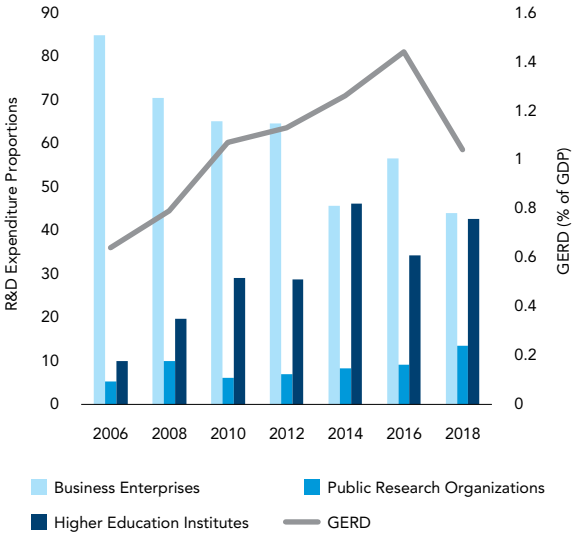
In the current context of global uncertainty, Malaysia's successful transition to a more innovation-based growth model has become even more imperative for it to achieve its aspirations of becoming a high-income economy. A significant share of income growth derives from productivity growth, particularly growth driven by innovations that render physical and human capital more productive (Cirera and Maloney 2017; World Bank 2018). While Malaysia has consistently recorded high rates of growth in recent years, the severe economic shocks it has faced have dented its growth momentum. To address this, a sustained increase in private investment, together with measures to improve productivity, will be necessary to compensate for subdued domestic demand and to maintain a sustainable economic growth trajectory. At the same time, in the context of 'new normal' conditions, increased digital and technological adoption will play an increasingly significant role in ensuring business continuity and in driving productivity improvements into the future.

At the global level, Malaysia's consistent efforts to improve its overall innovation ecosystem have resulted in it becoming one of the more innovative upper-middle-income economies. The government's ongoing efforts through a range of new policies and programs have resulted in an increased emphasis on facilitating the emergence of a more innovative and knowledge-based economy. The success of these efforts in recent years can be seen from the country's growth in innovative activities and outputs in the form of R&D and non-R&D innovations, such as patents and processes (World Bank 2020a). In studies on innovation, Malaysia ranks highly in terms of broad global indices such as the Global Innovation Index, ranking 33rd out of 131 economies in terms of overall innovation.[17] Amongst upper-middle-income economies, Malaysia ranks 2nd out of 37 economies, second only to China within the respective income levels.

Despite Malaysia's high level of innovation at the broad level, the intensity of its R&D has fluctuated over recent years, especially within the private sector, with its intensity in this sector lower than in more innovative countries. The latest National Survey of Research and Development, conducted by the Ministry of Science, Technology, and Innovation (MOSTI), shows that the overall R&D intensity in Malaysia, measured in terms of the gross expenditure of R&D (GERD),[18] has decreased from 1.4 percent of overall GDP in 2016 to 1.04 percent in 2018 (see Figure 29). At the same time, business enterprises in sectors that most consistently engaged in R&D have experienced the most significant decline in the overall proportion of R&D expenditure in the country, with the latest statistics suggesting that the proportion of expenditure for businesses is at a similar level to that for higher education institutions, at approximately 44 percent of total R&D expenditure. Part of this decline is due to the increase in expenditure by higher education institutions and government research institutions. Additionally, for business enterprises, the overall decline in GERD is mainly attributable to factors such as reduced R&D budgets, changes in firms' R&D cycle away from technology transfer to product stability, and the shifting of R&D activities to other countries (MASTIC 2020). Comparing Malaysia's R&D intensity to that elsewhere, it is clear that Malaysia's declining GERD is cause for concern, creating the possibility that it will fall even further behind in the area of innovation (see Figure 30). If current trends continue, it will be challenging for Malaysia to achieve the government's target of reaching a GERD level of 2 percent of GDP. This situation may have been further exacerbated by the impact of the COVID-19 due to the high levels of uncertainty that constrain businesses from making additional investments in R&D and to its impact on the government's fiscal position, which limits its ability to continue to allocate similar levels of budget funding as it did previously.

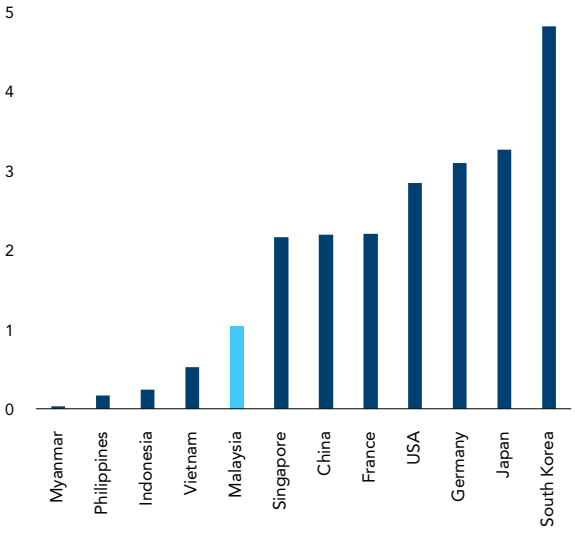
17 The Global Innovation Index assesses and aggregates numerous factors pertinent to innovation ranging from institutions, human capital, research, infrastructure, market and business sophistication, knowledge and technology outputs as well as creative outputs.
18 GERD is a common indicator for overall innovation, as a higher GERD generally correlates to better innovation outcomes for an economy. It also is a measure of a country's commitment towards innovation and R&D.

Figure 29: Proportion of R&D Expenditure by Sector and GERD (Percentage of GDP)



Source: National Survey of Research and Development (R&D) in Malaysia 2019

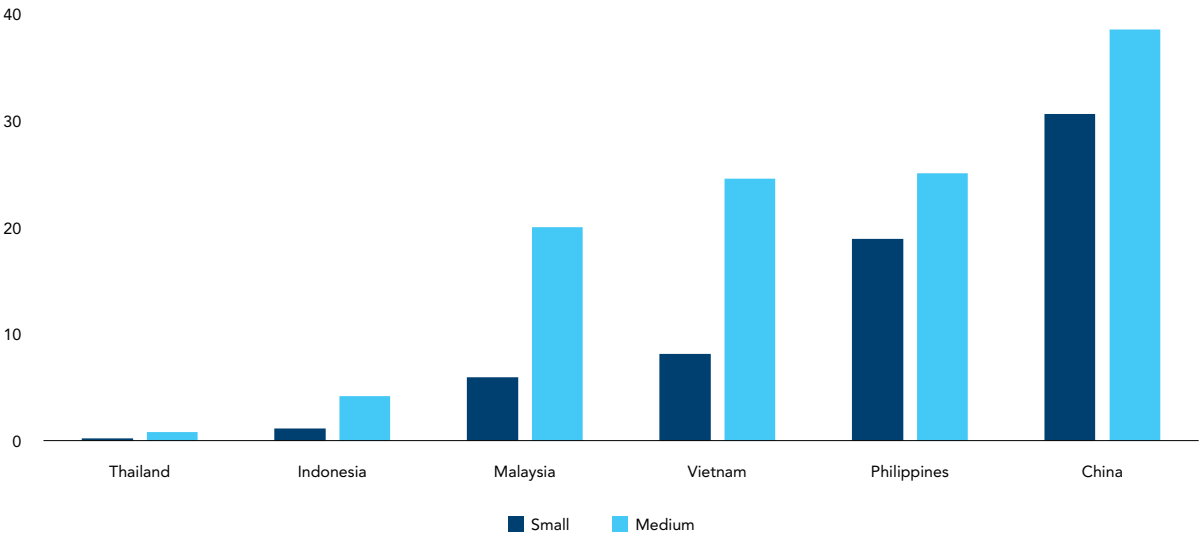
Figure 30: Comparison of R&D Intensity (GERD) as a percentage of GDP (latest available year)



Source: UNESCO Institute for Statistics and National Survey of Research and Development (R&D) in Malaysia 2019

The proportion of Malaysian SMEs that invest in R&D is significantly smaller than is the case for some of its regional comparators. In Malaysia, approximately 6 percent of small firms and 20 percent of medium-sized firms invest in R&D (see Figure 31). Although Malaysia performs well relative to some of its ASEAN neighbors, including Thailand and Indonesia, in the case of others, such as Vietnam and the Philippines, a much larger proportion of SMEs invest in R&D. China, the leader in these terms in the EAP region, clearly outperforms Malaysia, with 30.6 percent of small firms and 38.5 percent of medium firms investing in R&D.

Figure 31: Proportion of Small and Medium Firms Investing in R&D



Source: World Bank Enterprise Surveys

Malaysian firms in general, and most particularly its SMEs, continue to face a range of fundamental problems and challenges that constrain the adoption of innovation and technology. Malaysian businesses, especially SMEs, must address a number of issues that constrain their potential to become more competitive and innovative, with these challenges ranging from limited access to funding to poor within-firm capabilities. Malaysian firms tend to lag behind those in many other countries in similar income groups in terms of the adoption of digital technologies, particularly in the case of SMEs (World Bank 2018). Additionally, SMEs in Malaysia are less likely to adopt complex innovations and technologies in their businesses due to a lack of technical capabilities (World Bank 2020a). The government aims to address these issues through numerous policies and programs intended to assist and incentivize SMEs to innovate and to adopt new technologies and digital tools. The current global context has created a clear need for firms to find new ways of doing business, placing new emphasis on the need for increased technology adoption and digitalization, to which the government has responded through the introduction of a range of programs and assistance to support the achievement of these goals (see Box 3: COVID-19 SME Economic Stimulus Packages).

There is strong evidence to show that firms that innovate tend to be relatively more productive, making the need for Malaysia's SMEs to address their lag in this area imperative. Empirical evidence suggests that the likelihood of SMEs engaging in innovation is not only affected by the size of these firms, but also by other important factors, such as firm age, export orientation, the technological characteristics of the industry, and market concentration and competition (Lee and Lee 2007). Additionally, cooperative arrangements with foreign businesses tends to increase the likelihood of SMEs engaging in R&D (Lim and Fernandez 2015). Prior analysis in the World Bank's *Productivity Unplugged* study shows that Malaysian firms that have introduced a relatively high level of technical innovations generally have higher levels of TFP, with firms that have introduced non-technical innovations usually having higher rates of labor productivity (World Bank 2018). The study used data from the World Bank Enterprise Survey to enable a comparison between Malaysia's performance with those of other countries.

Malaysian firms that invest in R&D or that provide formal training to their workforce with the specific purpose of encouraging innovation also have higher rates of labor productivity. The study shows that the increase in productivity associated with both technical and non-technical innovation is particularly significant for medium-sized firms and that large firms and exporters tend to be more innovative than small firms and non-exporting firms. Furthermore, it finds that large firms in Malaysia are more likely than medium and small firms to engage in all three types of innovation (non-technical, technical, and R&D).[19] Other studies have also found that SMEs are less likely to engage in technical innovation and are more likely to engage in non-technical innovations (Chin and Lim 2018).

Additionally, businesses and institutions in Malaysia have achieved only limited success in transforming R&D output into commercial applications that can be utilized in industry, especially in the case of SMEs. World Bank (2020a) noted that technology transfer offices (TTOs) have been widely established by higher education institutions and public research organizations to facilitate the commercialization process. However, these TTOs are relatively new and undeveloped, lacking the know-how and expertise required to fulfil this role. A fundamental reason for this could be that the TTOs are generally regarded as poorly structured and not possessing sufficient intellectual property management skills to effectively conduct and facilitate the commercialization of research output (OECD 2016). The lack of support available for the development of these TTOs limits their effectiveness in translating R&D output to commercial success and facilitating its effective use by Malaysian businesses, especially SMEs, and thereby enabling them to gain a productive advantage.

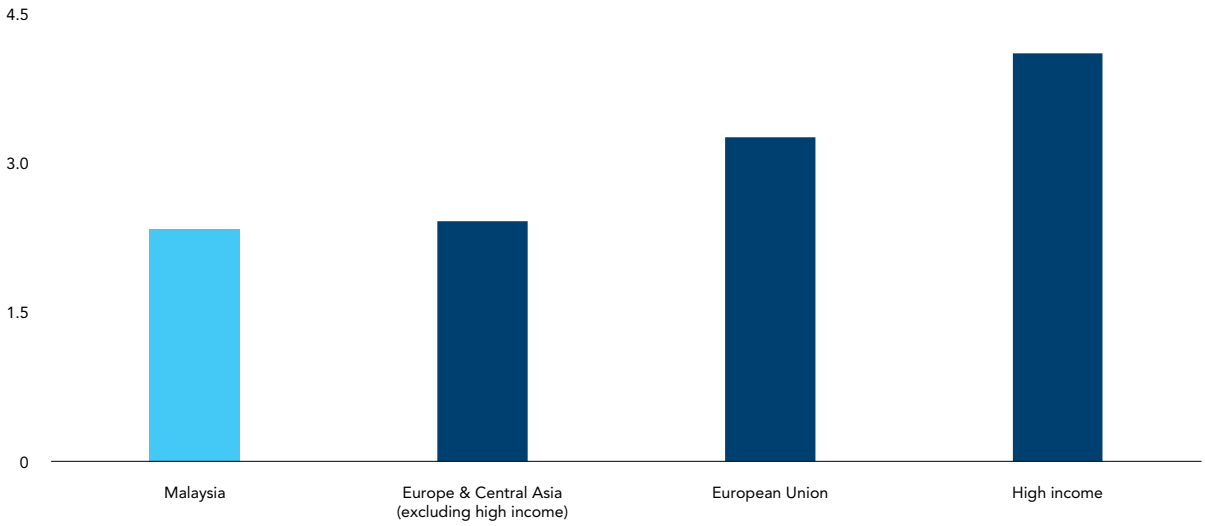
19 Technical innovation refers to development and introduction of a new product or new production process within the firm. Non-technical innovation involves the introduction of new organizational methods related to the practices, workplace or firm's external relations among other things.

Market and Institutional Factors

A range of market and institutional factors play a role in fostering private investments and ensuring productivity growth through innovation and entrepreneurship among SMEs. These factors include aspects of the enabling business environment, particularly available capital, skilled workforce, and a multitude of others. Malaysia has recorded good performance in terms of its overall business environment, with ongoing improvements over the past few years. In general, Malaysia has fared well in certain indicators that reflect the overall business environment such as the Global Competitiveness Report or the World Bank's Doing Business indicators. These indicators reflect that the range of reforms implemented recently by the Malaysian government has led to an improved business environment.

Nonetheless, despite these improvements to the overall business environment and while the rate of business formation in Malaysia is high compared to many other lower/middle-income economies, it is relatively low compared to the average for higher-income economies. Entrepreneurship and SME activity have been focused on the creation of new businesses, which has been essential for continued dynamism in the economy, fostering competition, and contributing to economic growth. Malaysia has recorded growth in new business density from year to year, reflecting improvements in the overall business environment and in the private investment climate. However, the average new business density[20] in the period from 2010 to 2018 was relatively low compared to the average for high-income economies (see Figure 32). This suggests that while the overall business and entrepreneurship environment has improved, the pace of these improvements needs to increase to enable Malaysia to catch up with the high-income nations.

Figure 32: Average Entry Density (2010-2018)



Source: World Bank World Development Indicator

20 Defined as the number of newly registered, limited liability firms as a percentage of the working age population (ages 15-64).

In Malaysia, persistent regulatory barriers have the potential to deter the new entry of firms into the market and to undermine general economic adaptability, especially in the case of smaller businesses. Factors that are pertinent to starting businesses, such as regulatory barriers, play an important role. Malaysia is ranked as the 9th most complex country in the world to do business according to the Global Business Complexity Index report, conducted in 2020. A contributing factor to this is the great number of licenses and authorizations required by businesses to start operating. Even though the process of incorporating a company is relatively quick and inexpensive, compliance with additional regulations distorts the overall process. Depending on the business sector and the type of products or services that the business intends to offer, several additional licenses may be required, in addition to compliance with general environmental, health, and safety regulations. The time and cost required to comply with these regulations place unnecessary constraints on smaller businesses, with a significant proportion of SMEs outsourcing this process by using agents (IDEAS 2020).

Although the government has implemented a number of remedial measures to address these issues, Malaysia still lacks mechanisms to simplify the onerous procedures of obtaining licenses. The introduction of mechanisms such as one-stop centers to facilitate business authorization through the MalaysiaBiz portal may eventually have the effect of simplifying the arduous process of obtaining business licenses and complying with certain regulations. However, with these centers only being launched in December 2020, it is still too early to assess the efficacy of this mechanism. It should also be noted that the burden of obtaining licenses is compounded by other requirements that restrict business activities (IDEAS 2020). While these restrictions vary across different industries and can be very nuanced, they are often difficult for SMEs to fulfil and can therefore limit the entry of new firms and hinder their potential to play a positive role in fostering innovation and excellence (ibid.).

Managerial practices play a substantial role in facilitating the achievement of higher levels of productivity and in enhancing other aspects of firms' performance. In recent decades, a substantial body of research has demonstrated the existence of a significant relationship between firms' management practices and their productivity and performance.[21] A more direct and recent analysis of Malaysian firms also found that the quality of firms' management practices (measured in terms of a management practice index) is associated with levels of productivity (in terms of both labor productivity and value added per worker and TFP).[22] It also found that there is a high degree of variability in management practices index scores within sectors in Malaysia.

A number of significant issues need to be addressed to improve the management practices of Malaysian firms and thereby boost their productivity. A recent study by the World Bank (2020f) found that while Malaysia's overall score in the World Management Survey is relatively high compared to the average for upper-middle income countries, it still has significant room for improvement. For instance, within firms' operations management, while modern processes may be implemented by manufacturing firms, they are often not fully formalized. In the area of performance monitoring and target setting, while the average Malaysian firm has a formal performance monitoring process, it may not have well-established follow-up plans or have only a limited system to enable employees to understand the organization's targets and their roles in achieving them. In the area of talent management, it also shows that the average Malaysian firm could achieve improved performance in terms of transparency and accountability in evaluating employees' performance. Additionally, it noted that smaller firms tended to achieve relatively low scores for management practices.

21 See Ichniowski et al. (1997), Black and Lynch (2001) or Bertrand and Schoar (2003).
22 World Bank (2020) 'Malaysia – Productivity and Investment Climate Survey (PICS 3)'

Skills and Training

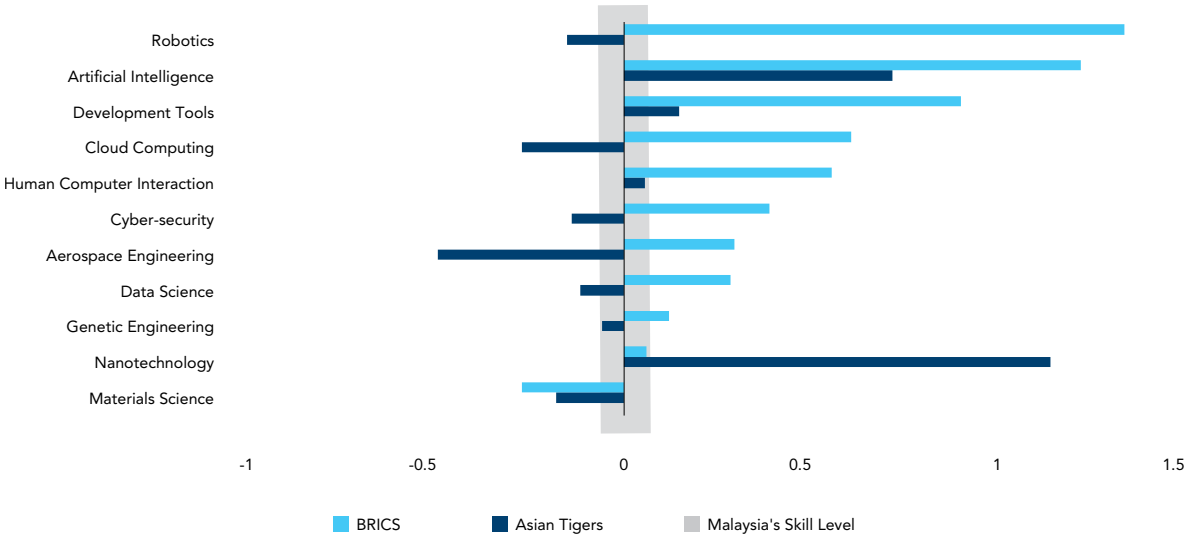
In the context of the rapid transformation of the business environment through the emergence of new technologies and other innovations and with the global uncertainty associated with the COVID-19 pandemic, it is clear that there is an intensifying need to improve the capabilities of Malaysian firms. As discussed in previous sections, the COVID-19 crisis has forced businesses to adapt through the increased use of digital tools to operate in the current environment. However, in order to effectively reap the benefits of digital technologies and to leverage them to enhance firm productivity and competitiveness, firms need to have the requisite skilled personnel. The COVID-19 pandemic has resulted in a growing awareness of the benefits that businesses (including but not only SMEs) can derive from using new technologies such as remote working facilities, online business platforms, and social media. While digital and technological skills will play an increasingly crucial role in the current business environment, other skills, including those related to managerial and organizational practices, will also be a major determining factor in firms' ability to innovate and to increase firm-level productivity and thereby to weather the current crisis and to achieve higher levels of resilience into the future.

With demand for digital skills increasing, critical skills shortages may persist in the overall economy and for SMEs in particular. Structural transformations at a global scale have led to an increased demand for digital skills. At the same time, the majority of Malaysian workers are classified as semi-skilled, which suggests that there is great potential to upskill (World Bank 2021a). Looking at LinkedIn data,[23] Malaysia lags behind comparable countries such as the BRICS[24] countries in terms of frontier skill penetration in areas such as robotics and artificial intelligence (see Figure 33). On the other hand, the level of these skills in Malaysia is closer to that found in the Asian Tigers,[25] albeit with better performance in some areas and weaker performance in other areas. Malaysia's strong performance relative to the Asian Tigers may be due to the inclusion of city-states such as Singapore and Hong Kong, with the lower presence of the manufacturing sector. However, those areas in which Malaysia seems to have a relative advantage, such as materials science, are areas that are mostly dominated by larger businesses that have the capacity and skills to operate in these fields. Additionally, there is a large demand for basic digital skills (digital literacy), with a large proportion of job listings requiring at least basic digital skills (see Figure 34 Panel A). At the same time, the demand for more complex digital skills, such as skills related to data science or development tools, is relatively smaller (see Figure 34 Panel B). This further suggests that the adoption of new technology in Malaysia is relatively slow and that as a result, there is only limited demand by firms for such skills at the present time. It also suggests that basic digital skills can be further enhanced. These findings on the demand for basic and more complex digital skills are consistent with the observation that the value of Malaysia's exports of high-skill global innovator products has declined since reaching a peak in 2006 and with the relatively poor performance of the country's businesses in terms of the digital adoption index (as seen in the trade and innovation sections).

A further examination of Malaysia's firm-level data shows that firms face difficulties in finding employees with digital, technical, and soft skills such as interpersonal and communications skills. Smaller firms in particular struggle to find employees with the required levels of interpersonal and communications skills, with approximately 65 percent of small firms reporting such problems (see Figure 35). In addition, 60 percent of such firms also reported difficulties finding employees with problem-solving or critical skills, while 58 percent reported difficulties finding those with computer or general IT skills. Medium and large firms[26]

23 LinkedIn does not have strong coverage of the Manufacturing sector as a whole; it has good coverage for high-skilled occupations (i.e., engineers and the operations managers working in manufacturing but not necessarily factory floor workers).
24 Excluding Russia since LinkedIn is not operating in this country.
25 Asian Tigers defined as Hong Kong, Singapore, South Korea, and Taiwan.
26 Ignoring the second language as it is not critical to how firms operate.

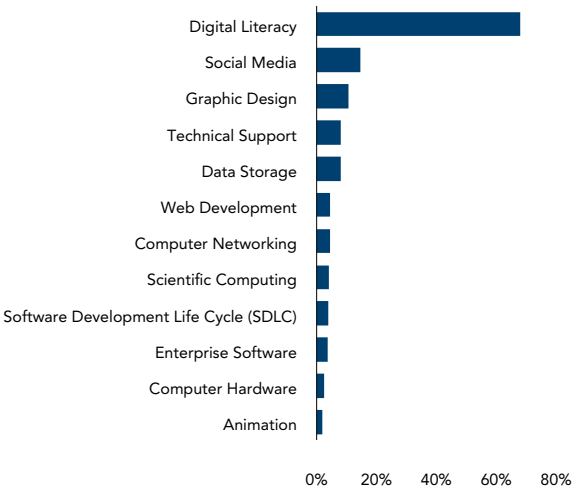
Figure 33: Index of Distance from Frontier Skills, Malaysia and Comparators



Source: "World Bank LinkedIn Digital Data for Development" by World Bank Group & LinkedIn Corporation, licensed under CC BY 3.0, 2015-2018.
Note: "Distance from Comparator" is measured as the difference between Malaysia's relative skill penetration and the comparator country group's relative skill penetration.

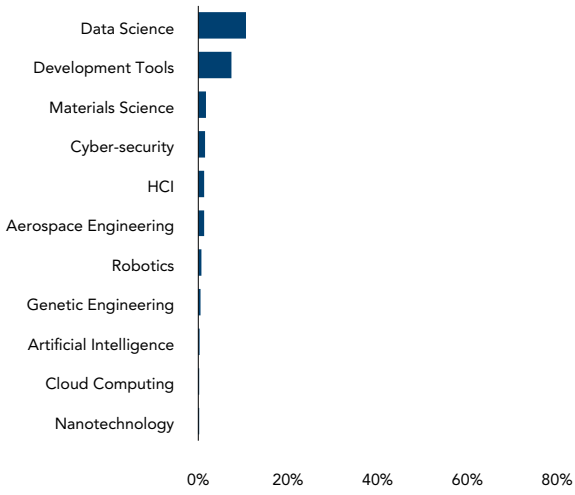
Figure 34: Occupations Mentioning Skill among Top 30 Skills (Percentage)

Panel A: Basic Digital Skills



Source: World Bank LinkedIn Digital Data for Development

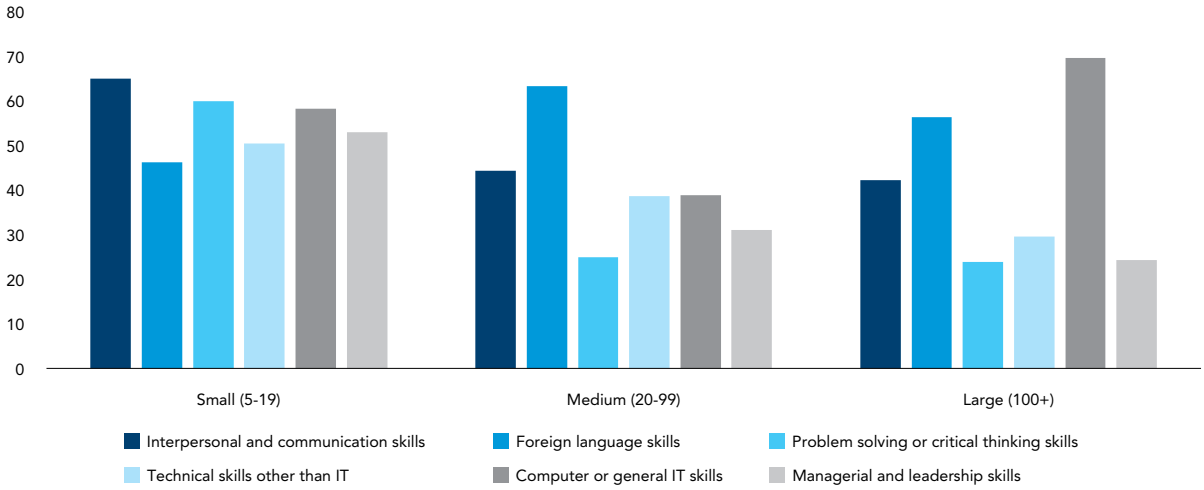
Panel B: Advanced Digital Skills



Source: World Bank LinkedIn Digital Data for Development
Note: HCI denotes Human Computer Interaction

also reported difficulties finding employees with adequate interpersonal and communications skills and with computer and general IT skills. In fact, the proportion of larger firms that reported facing difficulties finding employees with computer and general IT skills was higher than for smaller firms, possibly due to larger firms tending to adopt more complex technologies that require higher-level computer and IT skills (as previously discussed, larger firms tend to adopt new technologies and digital tools faster than small or medium firms). It was also found that the proportion of firms that face difficulties in finding employees with managerial skills decreases relative to the size of firms. However, the COVID-19 crisis may have altered this situation, with the demand for strong managerial or leadership skills having increased due to the need for firms to deploy such skills to sustain their operations in the current uncertain environment.

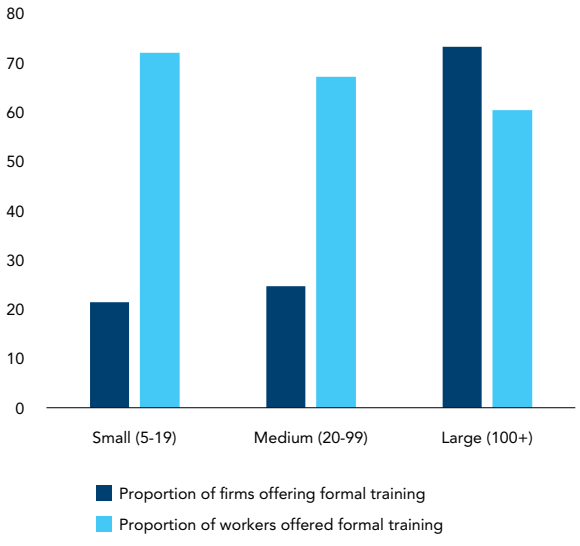
Figure 35: Proportion of Firms with Difficulty Finding Employees with Specific Skills (Percentage of Firms)



Source: World Bank Enterprise Surveys

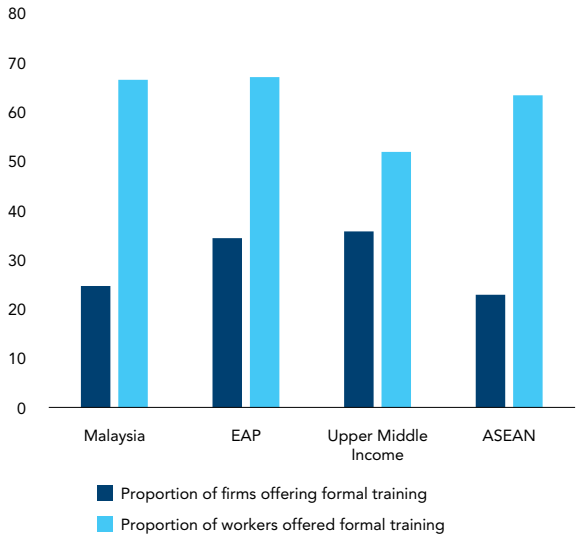
While the provision of training by employers is essential to enable businesses to upscale, this training is relatively limited in Malaysia, especially amongst small and medium firms. With the ever-changing environment, the need for firms, especially SMEs, to upscale is even more urgent than ever. The provision of formal training is one means to enable them to do so. However, small and medium-sized firms generally provide formal training to their employees only to a very limited extent (see Figure 36), with less than 25 percent of small and medium firms providing such training to their employees. However, it was also found that in cases where small and medium enterprises do provide formal training to their employees, they provide it to a higher proportion of their workers. Compared to neighboring countries in the region and to those at similar levels of income, Malaysia lags behind the EAP and upper-middle-income average, only performing better than the average level for the ASEAN region in terms of the provision of formal training for employees (see Figure 37).

Figure 36: Proportion of Malaysian Firms Offering Training by Size (Percentage)



Source: World Bank Enterprise Surveys

Figure 37: Proportion of Firms Offering Training – Comparisons with Other Countries (Percentage)

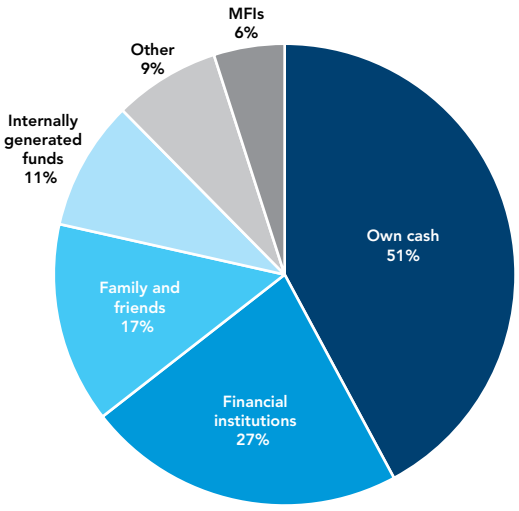


Source: World Bank Enterprise Surveys

SME Financing

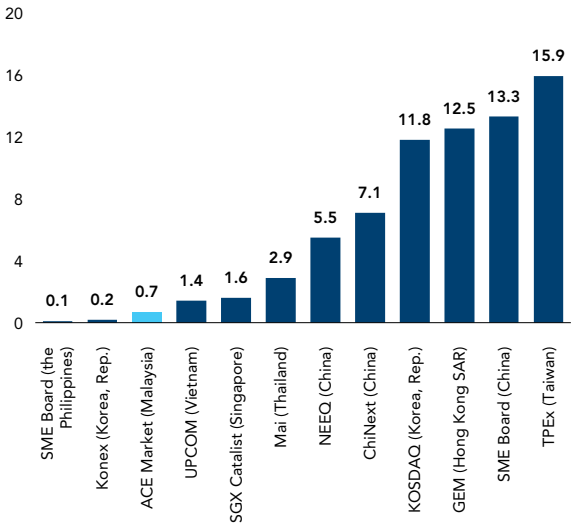
Most SMEs continue to rely on informal sources of financing,[27] albeit with financial institutions playing an important role in financing long-term loans for SMEs. A survey conducted by BNM in 2018 found that SMEs rely heavily on informal sources of funding, including self-financing (approximately 51 percent) and loans from family and friends (17 percent), with only 27 percent of respondents reporting receiving financing from a financial institution, of which the majority were banks (see Figure 38). Nine percent of respondents relied on other sources of financing, including government grants and alternative financing. Predictably, less mature SMEs relied to a greater extent on self-financing, with increasing use of external financing as their business progresses. At the same time, financial institutions play an important role in financing long-term loans for SMEs,[28] with short-term loans accounting for only 24.1 percent of all SME outstanding loans in 2017 (OECD 2020). Looking at the capital markets, the ACE Market, which serves as a complement to Bursa Malaysia and focuses on smaller companies with growth prospects, accounts for just 0.7 percent share of GDP, compared to 15.9 percent in the case of the Taipei Exchange (TPEx), an emerging stock exchange board in Taiwan (see Figure 39). Furthermore, nations such as Vietnam and Thailand have relatively greater SME-focused capital markets intensity than Malaysia, at 1.4 percent and 2.9 percent respectively. In 2017, Malaysia introduced the Leading Entrepreneur Accelerator Platform to enable SMEs to achieve greater fundraising visibility. Despite low trading liquidity and despite being restricted to sophisticated investors, the platform had 11 listings in 2019.

Figure 38: Sources of Financing for SMEs



Source: Bank Negara Malaysia

Figure 39: Market Capitalization of SME Focused Capital Markets (Percentage of GDP)



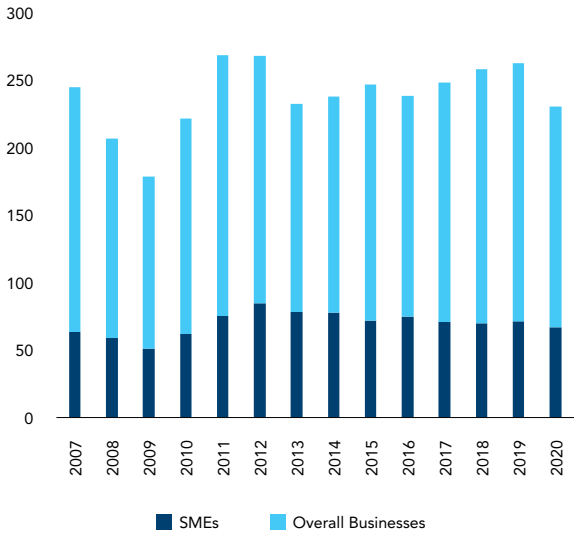
Source: World Bank, The Rise of Domestic Capital Markets for Corporate Financing

The total value of finance provided by financial institutions to SMEs has grown in the past decade, albeit with small declines in recent years. An examination of BNM data shows that while SMEs' share of the total finance provided by financial institutions has grown over the past decade, the SME share has wavered

27 Boosting Competitiveness Chapter in the Aiming High Study (World Bank 2021a)
28 Long-term financing is generally for large assets, capital expenditure or projects whereas short-term financing is used for working capital or general expenses incurred day-to-day.

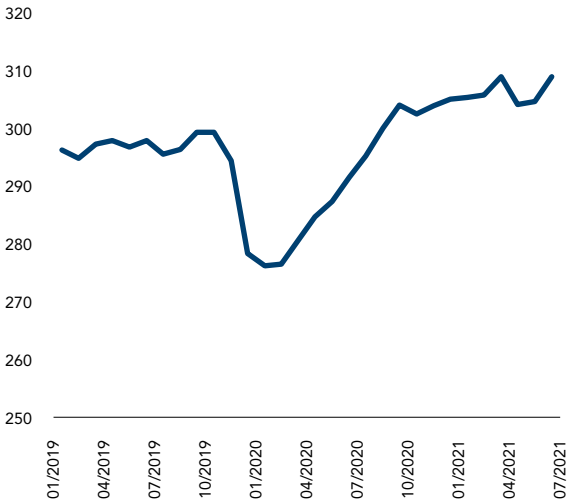
over the past few years, with a slight decline followed by an increase in the overall share of total business financing in recent years (see Figure 40). Additionally, the past decade has seen the total value of outstanding SME loans growing steadily (OECD 2020). However, there was a significant decline from the figure of RM320 billion (approx. US$ 79 billion) recorded in 2018 to RM278 billion (approx. US$ 69 billion) in 2019 (see Figure 41). This trend was reversed in 2020, with a sharp increase in the total overall value of outstanding loans to SMEs in response to the impacts of the COVID-19 pandemic on firms in Malaysia. By late 2020 and throughout 2021, the total outstanding loans for SMEs stood at a higher average level than periods prior to 2020.

Figure 40: Total New Lending (RM Billion)



Source: Bank Negara Malaysia

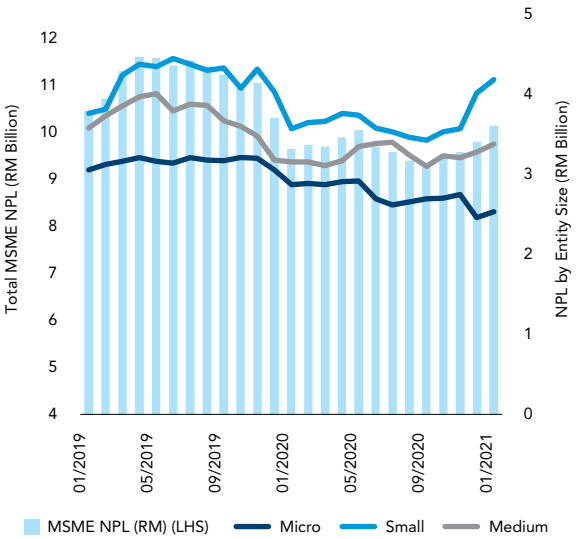
Figure 41: Total SME Outstanding Loans (RM Billion)



Source: Bank Negara Malaysia

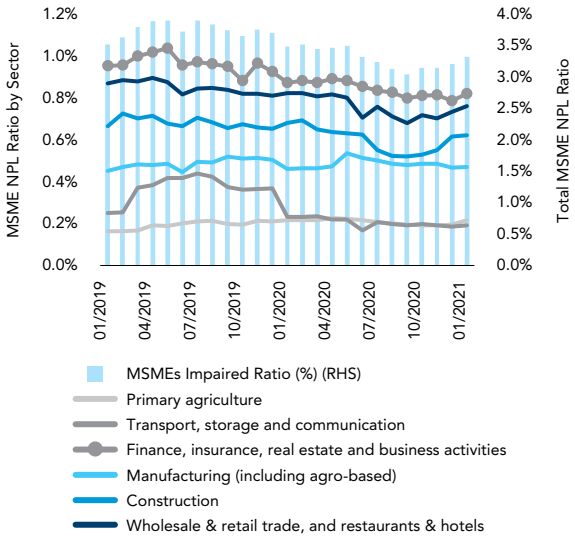
In 2020, the total value of loans to Malaysian SMEs remained at similar levels to previous years, despite the impact of the COVID-19 crisis, albeit with an increase in non-performing financing. The impact of the pandemic in terms of the level of non-performing loans (NPLs) is becoming increasingly apparent, with this level expected to increase as the pandemic-related government borrower relief programs come to an end. The six-month blanket loan repayment moratorium in place through September 2020 and the subsequent targeted repayment assistance initiatives for MSMEs have largely obscured the impacts of the pandemic on repayments. MSME NPLs began to rise after the end of the moratorium across enterprise sizes, to 3.2 percent in December 2020 (see Figure 42). The increase was most notable in three sectors, these being: finance, insurance, real estate (FIRE); wholesale and retail trade; and construction (see Figure 43). While there are signs of economic recovery, many MSME loans have been restructured and the full impact on the quality of the loan portfolio may not become fully apparent until later in 2022. In this context, banks have continued to set aside additional provisions as a precaution against future credit losses. However, it should also be noted that the total value of impaired SME financing in absolute and relative terms had been increasing even in the years preceding the advent of the crisis. Over the past decade, SME impaired financing substantively decreased from a peak of 7.5 percent in 2010, bottoming out in 2016 at approximately 3 percent (OECD 2020). However, over the past three years, SME impairments increased, reaching 3.74 percent in 2019, putting them almost at par with the share of large firms (OECD 2020).

Figure 42: Total MSME Non-performing Loans (RM Billion)



Source: Bank Negara Malaysia

Figure 43: MSME Non-performing Loans by Sector (Percentage)

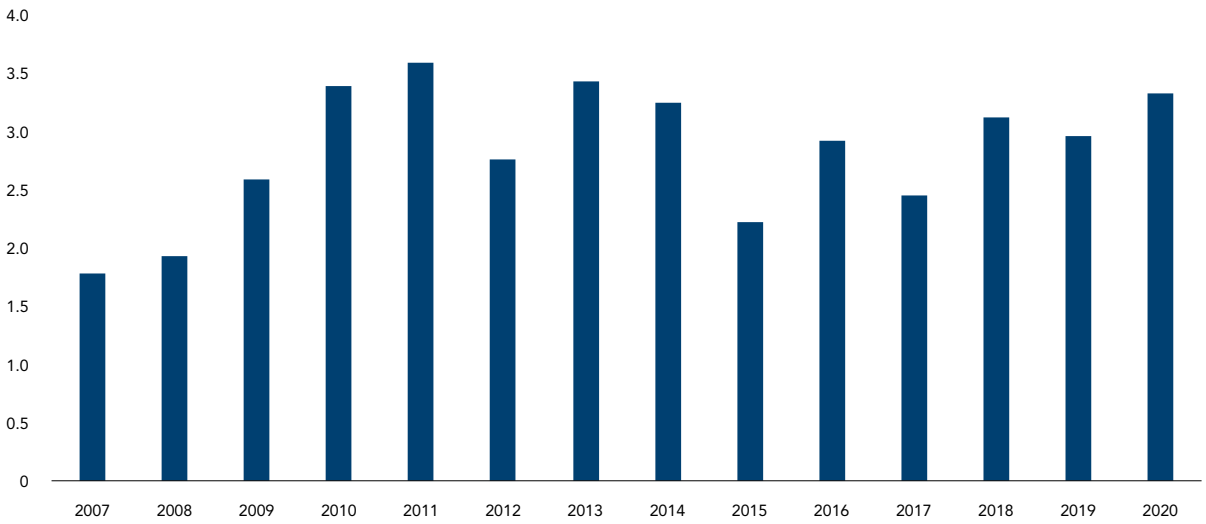


Source: Bank Negara Malaysia

While the share of finance provided by financial institutions to SMEs has increased over the past decade, SMEs continue to report constraints on access, particularly related to lack of collateral. An IFC study identified an MSME finance gap of 8 percent in Malaysia, which compares favorably to the regional average gap of 18 percent (International Finance Corporation 2017). A BNM survey of SMEs indicated that the most significant constraints that they faced related to documentation, collateral, and the perceived bankability of their businesses (Bank Negara 2018). Firms involved in process automation, innovation, and the manufacture of goods for export frequently reported that their requests for loans were rejected on the grounds of insufficient collateral, with most of these applications for machinery, equipment, and tools, all of which could involve movable or intangible assets that could serve as collateral in the case of default. However, unincorporated firms (70 percent of SMEs) cannot at present pledge movable assets as collateral. Factoring and leasing (which are popular asset-based financing instruments for SMEs in many countries) are both relatively insignificant in Malaysia, at 1.4 percent of GDP for factoring in 2018 and at 0.51 percent of GDP for leasing in 2017.

Over recent years, with the emergence of alternative financing sources, Malaysia has seen a widening and diversification of the financing landscape for SMEs. The government, through various ministries and agencies, now offers a wide range of funding and schemes (see the next chapter), with funding from non-banking institutions also starting to be widely available, including through the increasing number of venture capital and private equity corporations. At the end of 2020, there were a total of 127 registered venture capital and private equity corporations in the country, compared to 117 in 2018. At the same time, even though venture capital and private equity activities have been increasing, the total value of investments has fluctuated from year to year (see Figure 44). While the total value of investments declined significantly 2017, they bounced back in 2018 before facing a further slight decrease in 2019, and then bouncing back again in 2020. This is largely attributed to the increase in divestment activities during the year due to a restructuring exercise by major venture capital firms (Securities Commission 2019).

Figure 44: Total Venture Capital and Private Equity Investments at Year-End (RM Billion)



Source: Securities Commission Annual Reports

Summary of Country Needs Analysis

Policy support can play a pivotal role in enabling firms to grow and to become more productive. The justification for the provision of public support to SMEs tends to relate to the fact that SMEs contribute to a large share of employment and often face disproportionate levels of market failures. Based on a broad analysis of the overall SME and entrepreneurship conditions in the Malaysian economy, the following key policy priorities can be identified:

- **Improving firm capabilities** through measures to enhance managerial skills; to promote the adoption of new technologies, including digital tools; and to build entrepreneurial ecosystems, including through measures to enhance capabilities to undertake research and new product development.

- **Expanding access to markets**, both domestic and international, through measures to improve the national quality and standards infrastructure; to increase industry-research linkages; and to implement supplier and export development programs and policies.

- **Facilitating access to finance** through measures to strengthen financial infrastructure and to design and implement new financing instruments, including through measures to promote and leverage new fintech solutions.

- **Implementing a robust institutional framework** for the effective design and implementation of strategies to facilitate and support SME development.

CHAPTER 2

SME Policies and Programs

This chapter analyzes and discusses Malaysia's recent policies to foster the development of SMEs so as to assess the overall coherence of the SME program policy mix and to provide policy recommendations to serve as inputs for policymakers.

Malaysian SME Policy Framework

Currently, SME Corp is central to Malaysia's coordination efforts for the overall development of SMEs and entrepreneurship, as is evident in the 2019 SME program mix.[29] Under the purview of the Ministry of Entrepreneurship Development and Cooperatives (MEDAC), SME Corp plays a major role in the development of SMEs in Malaysia. In addition to formulating policies and strategies, SME Corp is also tasked with collecting relevant data and information from different ministries and agencies and reporting this data annually through the SME Integrated Plan of Action (SMEIPA). The purpose of SMEIPA is to enable SME Corp to conduct the monitoring and evaluation (M&E) of the programs' performance and achievements, thereby assisting in the formulation and implementation of further plans or strategies. At the same time, with the government's focus on entrepreneurship development, in the middle of 2019 the NSDC was rebranded as the National Entrepreneur and SME Development Council (NESDC), with SME Corp assuming the role of the secretariat to the NSDC. This led to the launch of the National Entrepreneurship Policy 2030 (NEP) in the middle of 2019 (see Box 4).

The NEP establishes new policy targets for SMEs and entrepreneurs for achievement by 2030, although these may be harder to meet than originally envisaged due to the current global crisis. While the government was able to steer the nation towards the targets set out in the SME Masterplan, it has fallen short of achieving them (World Bank 2020e). Apart from general goals regarding the development of SMEs and entrepreneurship (see Box 4), the NEP has established a number of national macro targets. Firstly, the NEP aims to improve Malaysia's rankings in terms of global indices such as the GEDI – Global Entrepreneurship Index, WEF – Global Competitiveness Index, the World Bank's Doing Business Survey, and the Global Innovation Index. The NEP has also set a goal of increasing SMEs' contribution to GDP to 50 percent, their contribution to total employment to 80 percent, and their contribution to Malaysia's total export value to 30 percent by 2030. At the point when this policy was first formulated (2018), SMEs' contribution to GDP stood at 38.3 percent; their contribution to employment at 66.2 percent; and to export value at 17.5 percent.

The uncertainty created by the pandemic may make it harder for the programs to individually align to these national objectives. The ambitious goals set by the government, combined with uncertain domestic and global economic conditions, create a need for the government to carefully design support policies and strategies to ensure that SMEs regain their momentum. In this context, there may be a need to revisit some of these overarching objectives (such as increasing the share of employment by SMEs to 80 percent), as the long-term objective should be to facilitate the growth of these firms to become larger and more productive firms and in turn to create more and better jobs.

In 2020, the government implemented a number of drastic changes to the overall policy mix for SME support and development. In the context of the COVID-19 pandemic, the federal government introduced numerous initiatives to assist households, SMEs and entrepreneurs to help sustain them through the crisis. The overall value of disbursements for SME support will undoubtedly increase in 2020 due to these new initiatives.[30] This study will only cover the SME support and development programs prior to the new programs or extensions introduced in the context of the pandemic. Some of the key support programs and initiatives are highlighted in the box included in the first chapter (Box 3: COVID-19 SME Economic Stimulus Packages).

29 A roadmap of the SME Policies to date is included in Appendix 3: Roadmap of Malaysia's SME Development Policies.
30 This is seen through an increase in the overall budget and spending on SME support and development reported by SME Corp. Further details are discussed in the proceeding section.

BOX 4

National Entrepreneurship Policy 2030

To enhance the development of SMEs and entrepreneurship in Malaysia, the Malaysian government, through the Ministry of Entrepreneurship Development and Cooperatives, launched the National Entrepreneurship Policy 2030 in July 2019. The NEP is a long-term strategy with the stated goal of transforming Malaysia into an entrepreneurial nation by 2030 and is consistent with the government's goal of facilitating the emergence of a prosperous, fair and inclusive economy.

The NEP identifies a number of key issues and challenges pertaining to entrepreneurship, with specific measures and strategies to alleviate these issues. It defines the eight main issues and challenges as follows:

1. **Entrepreneurial culture and mindset**
2. **Demographic changes and socioeconomic trends**
3. **Planning, implementation and performance monitoring**
4. **Inadequate procedures, policies and law**
5. **Limited access to funds**
6. **Slow technology adoption**
7. **Capacity, capability and scale of micro, small and medium enterprises**
8. **Education and skills**

In the context of current global economic developments, entrepreneurial achievements and the issues and challenges faced the nation internally, the policy outlines six core strategies to rectify the identified issues and to facilitate the emergence of a conducive entrepreneurial ecosystem in Malaysia. The six core strategies are supported by 19 supporting strategies and 62 initiatives. The six core strategies are:

1. **Inculcation of entrepreneurship at every level of society**
2. **Optimizing regulatory systems and access to financing**
3. **Stimulating integrated development and holistic entrepreneurship**
4. **Spurring growth through innovative enterprises**
5. **Improving capabilities and performance of SMEs**
6. **Internationalizing high growth companies.**

The SME Masterplan remains relevant to the achievement of many of the objectives established in the NEP. The core strategies of the policy are each associated with supporting strategies and initiatives. What is common to the supporting strategies and initiatives is the emphasis on inclusivity and the focus on the development of entrepreneurship among marginalized communities, including the B40 households, the indigenous people, the disabled and other disadvantaged or under-represented groups. At the same time, the goals set forth by the NEP rely on the platforms and programs within the SME Masterplan to support the development of entrepreneurship and SMEs in Malaysia. The government has further emphasized that for Malaysia to transform into an entrepreneurial nation, effective cooperation, coordination, commitment and support from a variety of stakeholders will be required. The focus should be on efforts to build a balanced and working relationship between the public and private sectors collectively.

Source: Adapted from the National Entrepreneurship Policy 2030.

Malaysian SME Program Mix and Program Efficiency Review

Over the years, the Malaysian government has introduced, implemented, and reformed numerous instruments and programs to support a wide variety of SME activities. This chapter analyzes the instruments and programs managed and reported at the national level through the SMEIPA. The overall objective is to provide an overview of the instruments, to analyze the cohesiveness of these policies, and to identify any potential issues with them. The chapter will start with an overview of Malaysia's SME development programs to provide the overall SME development landscape, identifying some key trends. This will be followed by an analysis of the types of programs and instruments available, highlighting how the programs can help achieve their intended economic and societal outcomes as well as their intermediate objectives. Other areas such as sectoral, regional, and technological development will also be analyzed. Finally, the analysis will highlight some of the key features of the programs being implemented and identify some key areas of concern.

The framework for analyzing the quality of the policy mix examines the policy priorities for SME development and innovation and the set of policy instruments to determine the extent to which they are in alignment. At its core, the analysis goes from descriptive to prescriptive analytics by evaluating the coherence between priorities and the portfolio and by assessing the internal consistency of the policy mix. Since the policy portfolio tends to grow organically, it is common to find some degree of fragmentation, overlapping policies, and legacy programs that are ready for rationalization.

Given the considerable fiscal challenges resulting from the impact of the pandemic, there is an urgent need to increase efficiency gains from publicly supported programs. Prior to the crisis, the combined impact of a persistent decline in revenue and increased committed expenditures had already narrowed fiscal space. Increased public spending in response to the pandemic has exacerbated this. At this level, the medium-term objective of fiscal policy will need to be on rebuilding fiscal buffers through fiscal consolidation, which limits the scope for measures to facilitate medium-term growth through the application of fiscal policy. Additionally, the role of government policy is expected to shift towards facilitating private sector growth, increasing the need to ensure the efficient execution of policies and programs.

To determine whether the current policy mix is capable of responding to the most pressing needs of SMEs and to identify opportunities to improve efficiencies, SME and entrepreneurship development programs from the SMEIPA have been mapped into a detailed matrix. Over 270 different programs and instruments have been meticulously mapped into a matrix containing detailed information regarding each SME program. The value of these programs in proportion to GDP is high for Malaysia relative to comparator countries, at almost 1 percent of GDP in 2018 and approximately 0.63 percent of GDP in 2019.[31] These programs refer to the aggregate distinct/unique number of programs that were available in the period from 2016 to 2019. This was calculated using data provided by SME Corp, combined with information sourced from program documentation and communications with some implementing agencies. It should also be noted that each program can be mapped to a specific implementing agency, which in turn is under a specific ministry. A multitude of variables were obtained from the mapping exercise using certain criteria for the scope of this analysis.[32] It is important to note that the programs covered in this program efficiency review (PER) only include those that are reported under the SMEIPA, with these programs mostly implemented by government agencies

31 Philippines spends around 0.15% of GDP whereas Czech Republic at around 0.4% of GDP for their latest available year.
32 Details regarding the analytical framework can be found in Appendix 4: Analytical Framework and Methodology. Appendix 4 also contains a detailed explanation of the process and information about how to the programs are mapped.

or government-linked institutions. It thus does not capture instruments or programs such as tax incentives for SMEs or development programs that are wholly funded through private-sector initiatives. While some of the key tax incentives are briefly discussed in this study (see Box 5), they are not included in the analysis due to the lack of available data. It is also important to highlight that these programs include all programs for which SMEs were eligible, including programs open to large firms. The analysis, however, has been restricted to SMEs.

There is a large number of active SME support policies and mechanisms of intervention. The portfolio of SME support programs largely consists of programs that provide financing to firms, training and education for SMEs and entrepreneurs, and credit guarantees. Credit guarantees are arrangements in which an agency guarantees to provide collateral or to secure the loans of SMEs in the event of default. Additionally, the values of the programs described and analyzed in this study reflect the expenditure incurred in implementing the programs and the value of support that beneficiaries receive. It should be noted that the values of credit guarantees are tied to that of the disbursed loans or credit.

BOX 5

Main Tax Incentives for SMEs in Malaysia

In Malaysia, a range of tax incentives are available for tax resident companies or entities, some of which are specifically intended for SMEs and some of which are targeted specifically towards producers of the main government-promoted products and categories, including green products, healthcare and wellness, tourism, biotechnology, manufacturing, ICT, education and shipping and logistics. The most important of the SME tax incentives include the Pioneer

Status, Investment Tax Allowance, Reinvestment Allowance, Accelerated Capital Allowance and Industrial Building Allowance schemes. Additionally, SMEs may also benefit from the Incentives for Export and Exemption from Import Duty on Raw Materials/Components.

Pioneer Status

The Pioneer Status is an exemption from the payment of income tax on between 70 to 100 percent of a company's statutory income for a period of 5 to 10 years. This tax incentive is only applicable to SMEs that produce government-promoted products or participate in promoted economic sectors.

Investment Tax Allowance

The Investment Tax Allowance is an alternative to the Pioneer Status, with the two schemes being mutually exclusive. While the requirements for the Investment Tax Allowance are the same as the requirements for Pioneer Status, the allowance covers 60 to 100 percent of qualifying capital expenditure (factories, plant, machineries or other equipment used for the approved project within the aforementioned sectors) for a period of 5 to 10 years.

Reinvestment Allowance

The Reinvestment Allowance is provided for a 15-year period to existing companies engaged in manufacturing and selected agricultural activities that reinvest for the purpose of expansion, technology uptake or the diversification of existing businesses into any related product within the same industry. This allowance is provided at the rate of 60 percent of qualifying capital expenditure incurred and can be offset against 70 percent of the entity's statutory income.

Accelerate Capital Allowance

This allowance is available to companies that reinvest in the manufacture of promoted products after receiving the Reinvestment Allowance for 15 years. It provides an initial allowance of 40 percent and then 20 percent, with capital expenditure exempted for those three years.

Industrial Building Allowance

The Industrial Building Allowance is granted to companies incurring capital expenditure on the construction or purchase of a building that is used for certain specific purposes such as manufacturing, agriculture, mining and infrastructure facilities. Companies are eligible for an initial allowance of 10 percent and an annual allowance of 3 percent (written off in 30 years)

Allowance for Increased Export and Exemption from Import Duty on Raw Materials or Components

This allowance provides tax exemption of 10 and 15 percent for exported products that gain at least 30 and 50 percent value added respectively. In the case of the automotive industry, it allows for exemptions of 30 and 50 percent for corresponding levels of value-added to exports. In addition, it provides a full exemption from import duties for raw materials in government-promoted sectors and industries.

Apart from these broad categories of incentives, there are also numerous specific tax incentives that are too many to list for specific sectors and the industries within.

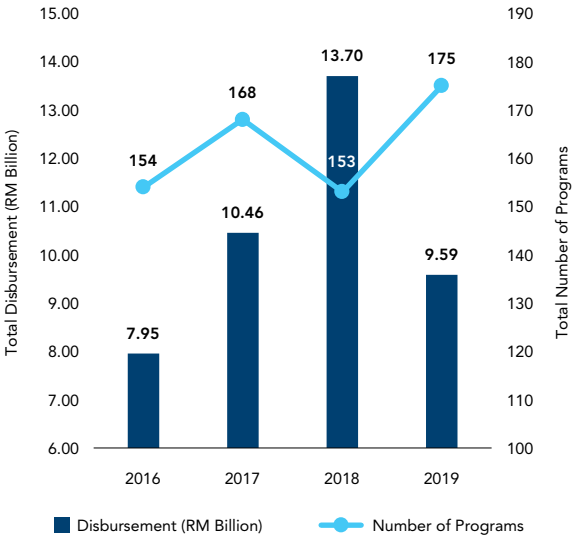
Source: Adapted from SME Corp: Tax Incentives for Malaysia

An Overview of the SME Programs in Malaysia

While the number and range of SME support activities has increased in recent years, there has been a decline in the disbursements of the allocated budget, indicating possible design issues, lags in disbursements, or implementation difficulties. SME Corp reported that the total number of SME programs has increased to its highest level in recent times, with a total of 175 programs in 2019, increasing from 153 programs in 2018. The number of current programs is significantly higher than the number of programs available in 2016 and 2017 (see Figure 45), with the total number of programs being reduced drastically between 2017 to 2018 due to a number of programs merging with closely related programs and to restructuring efforts resulting from changes to the ministries, which involved a reshuffling of implementing agencies.[33] While the disbursements of funds for SME programs showed an increasing trend in the period from 2016 to 2018, they fell drastically in 2019, coinciding with a slight drop in the allocated budget. In 2018, approximately 96.1 percent of the allocated budget, or RM 13.7 billion (approx. US$ 3.4 billion) out of RM 14.26 billion (approx. US$ 3.6 billion), was disbursed, with this rate dropping to around 70 percent in 2019, at RM9.59 billion (approx. US$ 2.5 billion) out of RM13.7 billion (approx. US$ 3.4 billion) (see Figure 46). However, a more recent report by SME Corp shows a significant increase in the total number of programs being implemented and the total value of disbursements, with the total number of programs increasing to 211 and with the total value of disbursements standing at around RM13 billion in 2020.

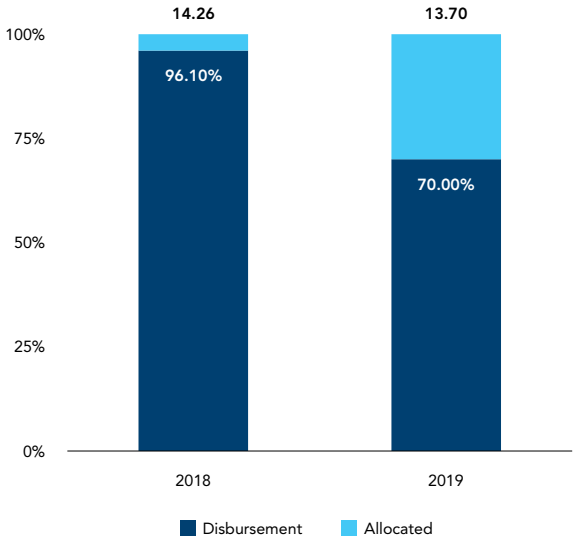
The increase in the total number of programs signals the government's commitment to developing SMEs in certain areas that were not previously strongly supported. However, a substantial decrease in the total value of funds disbursed relative to the funds allocated in 2019 could potentially signal a disconnect between the programs being implemented and the support required by SMEs. It could also signal a potential issue in the design of the programs, suggesting that they are difficult for SMEs to access. The aforementioned propositions will be further investigated in a deeper efficiency or functional analysis of the program portfolio.

Figure 45: Total Number of SME Development Programs and Total Funding Disbursed (RM Billion) (2016 – 2019)



Source: SME Annual Report and SMEIPA

Figure 46: Funds Allocated (RM Billion) and Proportion Disbursed (2018 – 2019)



Source: SME Annual Report and SMEIPA

33 It should be noted that these figures include government funded programs and privately funded programs that are associated with some governmental agencies, government-linked companies or companies limited by guarantee.

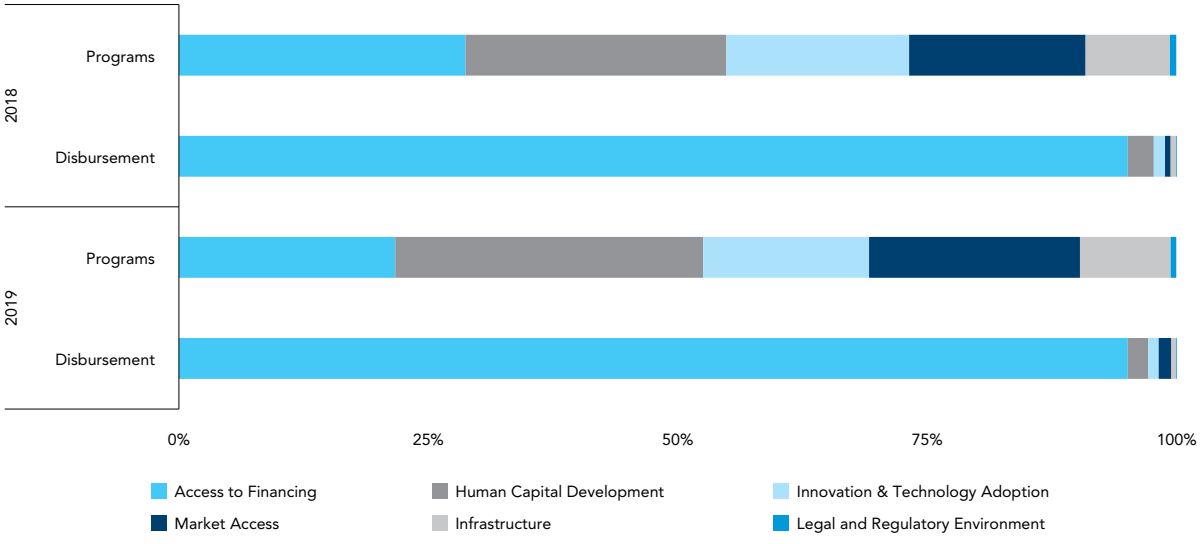
While the number of programs that focus on human capital development and/or that promote the uptake of innovation and technology has increased, the total value of disbursements for these programs has declined. A notable change is the increase in the number of programs that focus on improving market access (both domestic and international market access), up from 27 to 37 programs, with the total value of disbursements for these programs increasing from RM77.6 million (approx. US$ 19 million) to RM123.32 million (approx. US$ 30 million) (see Table 4 and Figure 47). The government's efforts to achieve fiscal consolidation may at least partially explain the shift away from programs that focus on financing and towards programs that increase SMEs' capabilities, competitiveness and resiliencies of SMEs through programs that support human capital development and market access.

Table 4: Evolution of Programs and Disbursement by the Government's Focus Areas

	2018		2019	
	Number of Programs	Disbursement (RM Million)	Number of Programs	Disbursement (RM Million)
Access to Financing	44	13,029.70	38	9,122.15
Human Capital Development	40	361.23	54	193.12
Innovation & Technology Adoption	28	159.28	29	100.69
Market Access	27	77.56	37	127.32
Infrastructure	13	69.16	16	42.42
Legal and Regulatory Environment	1	8	1	5.46

Source: SMEIPA and SME Annual Report

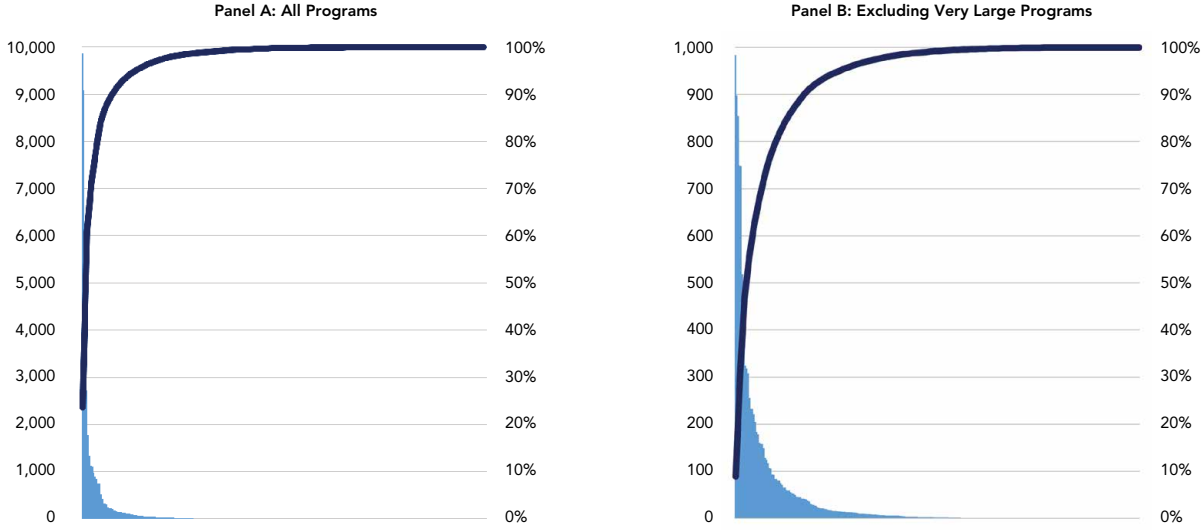
Figure 47: Proportions of Programs and Disbursement by the Government's Focus Area



Source: SMEIPA

The total value of disbursed funds across all programs varies greatly, with a high proportion of these funds concentrated within a few programs for SMEs. Analyzing all the programs that were in existence from 2016 to 2019, it can be seen that a large proportion of the disbursements are concentrated in a few programs. In fact, the five largest programs account for more than 80 percent of total disbursements (see Figure 42 Panel A), with these programs largely providing loans for SMEs. At the same time, a large number of programs operate on a small scale. Similar patterns can be observed when large programs are omitted from the distribution[34] (see Figure 48 Panel B). Though the disbursements are less concentrated, larger programs (from this subset of programs) still persistently account for a substantial share of overall disbursement, while most other programs operate at small and sometimes miniscule scales. Additionally, this suggests that there are very large variances in the disbursements for each program and hence the total number of beneficiaries they can potentially benefit.

Figure 48: Distribution of SME and Entrepreneurship Programs (disbursement in RM Million aggregated from 2016 to 2019)



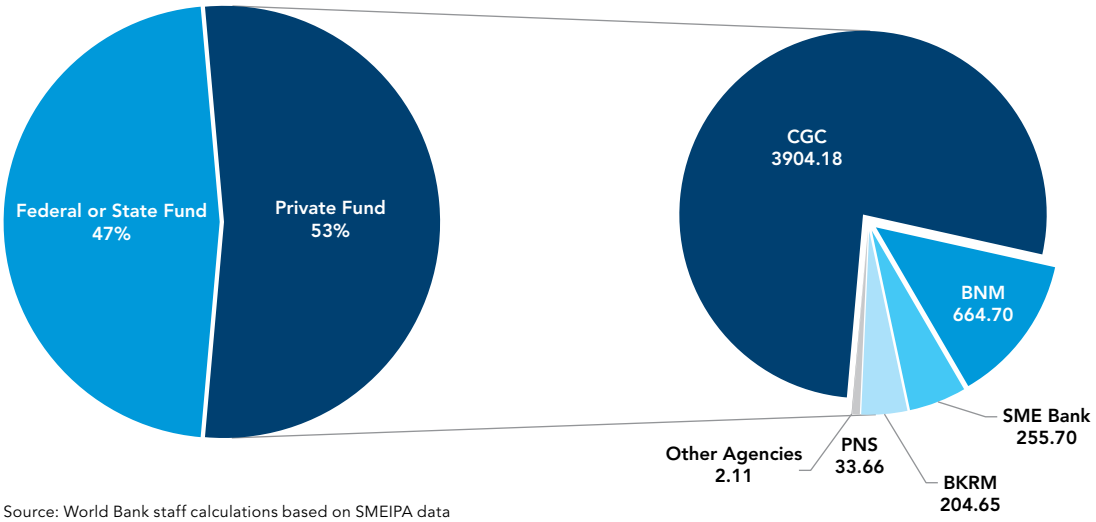
Source: World Bank staff calculations based on SMEIPA data

In recent years, there has been an increase in programs involving funding from private institutions. This refers to programs that involve funding from private institutions such as banks, private companies or companies limited by guarantees but that are still tied to or implemented by government agencies, departments or government-linked institutions. Part of this increase was due to the increased involvement of commercial banks. From 2017 onwards, numerous commercial banks entered into agreements with the Credit Guarantee Company (CGC) for the provision of SME loans through the CGC's portfolio guarantee schemes.[35] In 2019 alone, these programs account for approximately half of the total funds disbursed (it should be noted that these programs also involved other agencies and entities such as the central bank, BNM, among others; see Figure 49).

While the implementation of SME support programs involves most federal ministries, disbursements are largely managed by non-ministerial bodies or agencies. Together with state governments and non-ministerial bodies or agencies, a total of 16 different federal ministries are responsible for the management of these programs. In 2019, the disbursements of funds were largely managed by non-ministerial bodies,

34 This refers to the programs that have total disbursements larger than RM10 billion within the 2016 to 2019 period.
35 Each agreement with different commercials were valued at various amounts. In 2018, Maybank entered into an agreement with CGC that amounted to RM2 billion. In 2019, CIMB entered into a similar agreement with the same amount. Other commercial banks such as Hong Leong, OCBC, Standard Chartered and numerous others have entered into the same agreement from 2017 onwards.

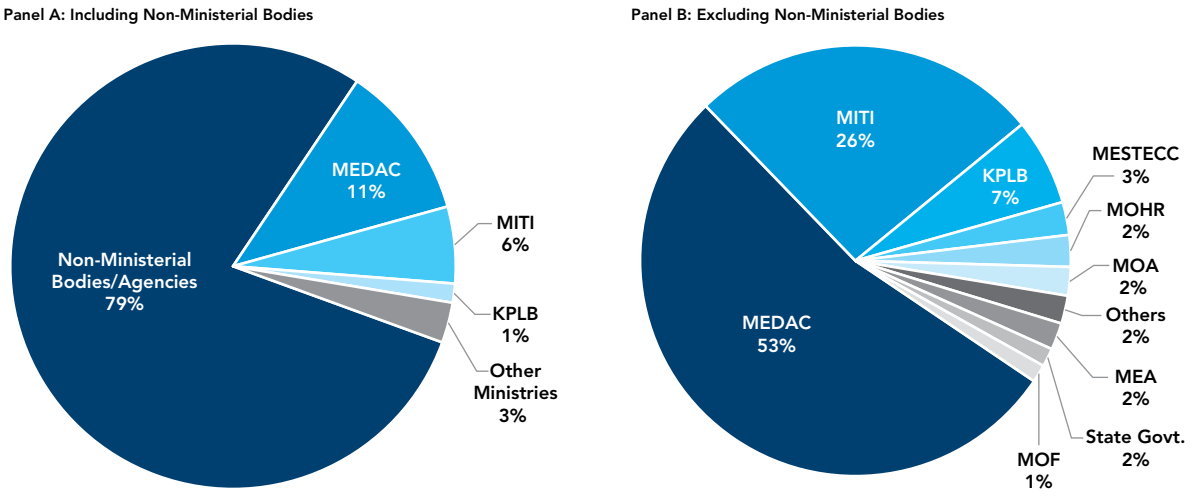
Figure 49: Proportion of Disbursements by Types of Funds and Share of Private Disbursement by Agencies in 2019 (RM Million)



Source: World Bank staff calculations based on SMEIPA data

which handled approximately 79 percent of all disbursements, with the remainder coming from federal and state ministries or governments (see Figure 50 Panel A).[36] This is largely driven by the presence of large and overarching programs that covers a wide range of SMEs in Malaysia. This pattern has held consistently over the past few years. Looking at programs implemented through the ministries only, it is no surprise that the MEDAC accounts for a large proportion of funding disbursements, at approximately 53 percent, as it is the central ministry with a clear mandate for the development of SMEs, entrepreneurs and cooperatives (see Figure 50 Panel B). This is followed by programs implemented by MITI and the Ministry of Rural Development (KPLB), at 26 percent and 7 percent respectively. Programs under MEDAC encapsulate a wide range of activities and industries, while the programs under MITI largely focus on industrial SMEs and are intended to facilitate increased productivity and/or exports.

Figure 50: Proportion of Funding Disbursement by Ministries in 2019

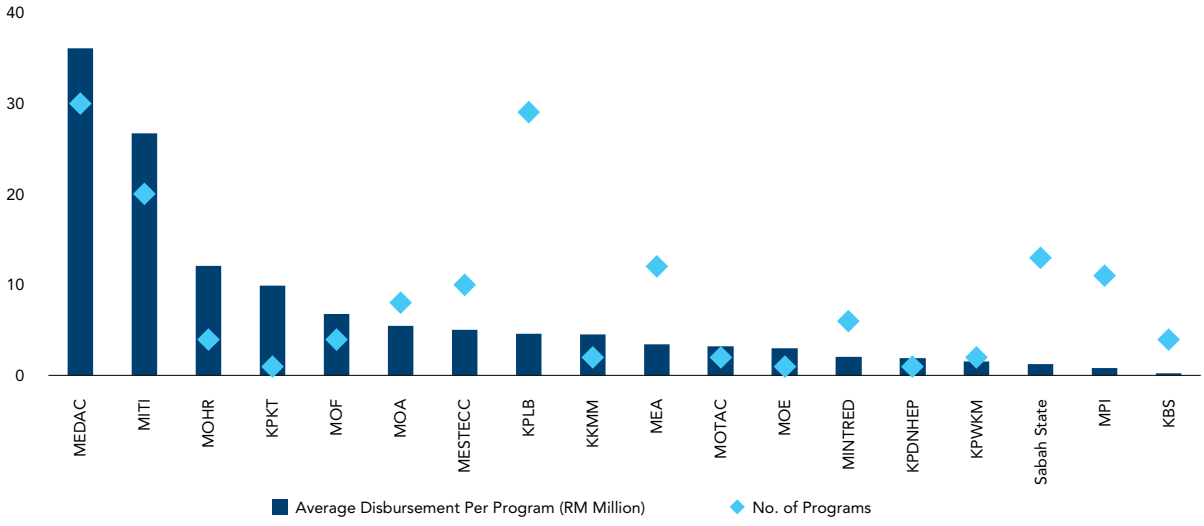


Source: World Bank staff calculations based on SMEIPA data
Note: This figure reflects the ministerial structure of 2019, before the restructuring of ministries by the incumbent government.

36 This refers to companies or organizations that are linked or related to governments but are not considered federal agencies or fall into any ministry.

There are large variations in terms of program sizes across ministries, with some programs having only small budget allocations and disbursements.[37] As previously mentioned, MEDAC is the ministry with the highest average disbursement per program, at approximately RM36 million (approx. US$ 8.9 million), followed by MITI, at RM 27 million (approx. US$ 6.6 million) per program (see Figure 51). However, a large number of ministries work with much lower average disbursements per program. An example is the Ministry of Rural Development under which, in 2019, there were 29 programs, with a relatively low budget of RM4.6 million (approx. US$ 1.1 million) per program. This variance is largely due to the nature and scope of the programs under each ministry. Ministries with overarching programs tend to have a larger number of programs spread out across different areas of focus or that target a range of different beneficiaries, with these ministries operating with smaller disbursements per program. Additionally, ministries with a larger number of programs tend to cover a wider range of beneficiaries or to target different aspects of SME development, also potentially leading to smaller disbursements per program. For instance, programs under a particular ministry may target a specific industry, but also with individual programs to target specific groups such as youth, women entrepreneurs and others.

Figure 51: Average Disbursements per Program and Number of Programs Across Ministries in 2019



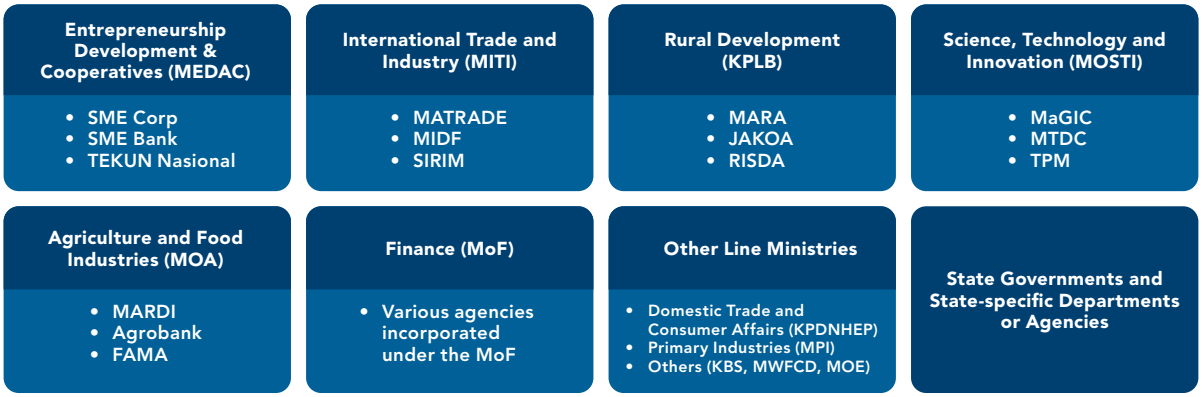
Source: World Bank staff calculations based on SMEIPA data
Note: This figure reflects the ministerial structure of 2019, before the restructuring of ministries by the current incumbent government.

The involvement of this large number of ministries and agencies has led to fragmentation, potentially decreasing the efficacy of program implementation. In the period from 2016 to 2019, more than 270 different SME support programs were implemented by more than 80 different agencies across most of the line ministries. In 2019 alone, 71 different agencies, ministerial departments and government-linked companies oversaw the implementation of SME and entrepreneur support programs across Malaysia (see Figure 52). Select government agencies across various ministries are involved in spearheading the provision of SME support in differing areas of focus, including support for microenterprises, tech-entrepreneurship, export enhancement and others (see Figure 53). The number of programs and their respective size also varies greatly across agencies, as discussed earlier. Furthermore, certain agencies have to coordinate their implementation efforts with those of other implementing partners. Fragmentation across niche areas or targets is not uncommon in other countries that also tend to segment ministries/agencies in a similar manner. However, the impact of fragmentation on

37 This excludes any programs that are not directly under any federal or state ministries.

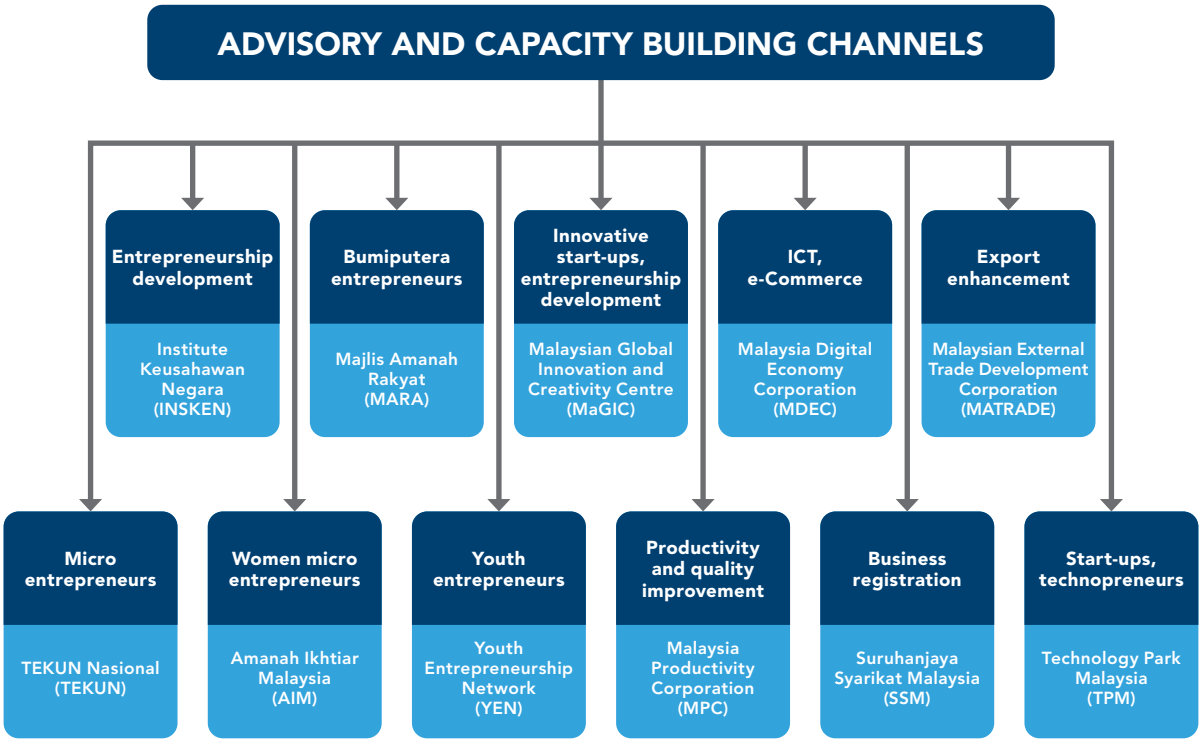
effective coordination across ministries/agencies in the implementation of activities is an even more serious concern. Though SME Corp is the central coordinating agency for SME and entrepreneurship programs, its role in implementing more than 150 different programs each year is likely to be associated with significant coordination challenges.

Figure 52: Relevant Ministries and Ministries Involved in SME and Entrepreneurship Development



Source: Authors' illustration
Note: This illustration is not extensive as there are more ministries, agencies and departments involved in implementing SME support programs.

Figure 53: Advisory and Capacity Building Channels for SMEs and Entrepreneurs



Source: Adapted from Bank Negara Malaysia

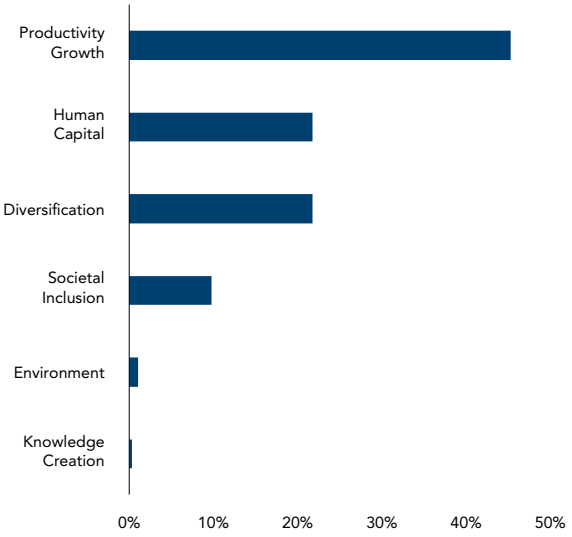
The subsequent sections of this chapter will assess the SME and entrepreneurship development programs previously described in brief in greater detail. As stated earlier, numerous aspects of the SME programs are assessed and mapped into a matrix with several profiling parameters. The statistics and graphs presented in the next section may differ in some details from information prevented in the needs assessment, which relies on previously published documents and on government statistics that may use different classifications.[38]

Economic and Societal Outcomes, Intermediate Objectives and Types of Instruments

Programs by Societal and Economic Outcomes

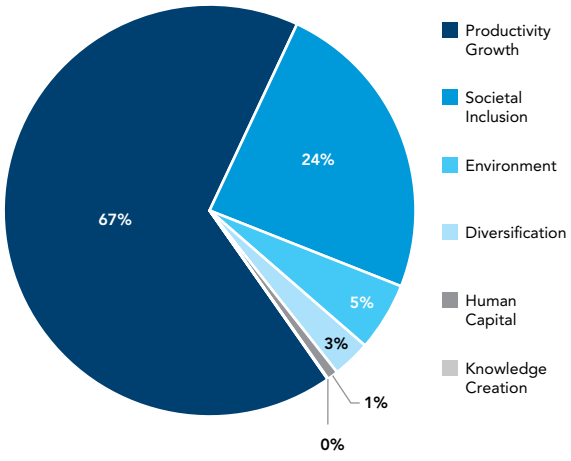
Most of Malaysia's SME development and entrepreneurship programs target productivity growth as the primary desired economic or societal outcome. Though these programs may have multiple intended economic or societal outcomes, the largest number of programs (accounting for more than 40 percent of all the programs in the period from 2016 to 2019) targeted productivity growth as their main intended outcome (see Figure 54).[39] These programs cover a wide range of activities and objectives, including the scaling-up of firms, increased technology uptake, product development and other activities that ultimately lead to improved productivity and performance. This is followed by programs that are intended to facilitate human capital development and economic diversification, with these programs accounting for approximately 22 percent of the total number of programs respectively. Programs that mainly targeted societal inclusion largely focus on supporting specified disadvantaged and/or underrepresented target groups through measures to encourage

Figure 54: Share of Programs by Main Economic or Societal Outcomes (aggregated from 2016 to 2019)



Source: World Bank staff calculations based on SMEIPA data

Figure 55: Share of Disbursement by Main Economic or Societal Outcomes (aggregated from 2016 to 2019)



Source: World Bank staff calculations based on SMEIPA data

38 For further details, please refer to Appendix 4: Analytical Framework and Methodology.
39 Most programs would have at least two different economic or societal outcomes, but the most prominent and relevant targeted outcome of each program was considered when mapping and calculating the statistics presented.

and enable them to engage in income-generating activities. In particular, the specified target groups include single women, indigenous peoples and B40 households. Lastly, there are limited programs that are explicitly intended to address environmental issues and/or climate change and knowledge creation.[40] In general, programs with environmental goals aim to encourage SMEs to adopt newer, greener technologies in order to promote more sustainable production and business operations. These programs may involve the provision of financial support or certification programs that relate to the adoption of green technologies. On the other hand, programs targeting knowledge creation aim to bolster public and private research networks and to increase the involvement of SMEs in these networks.

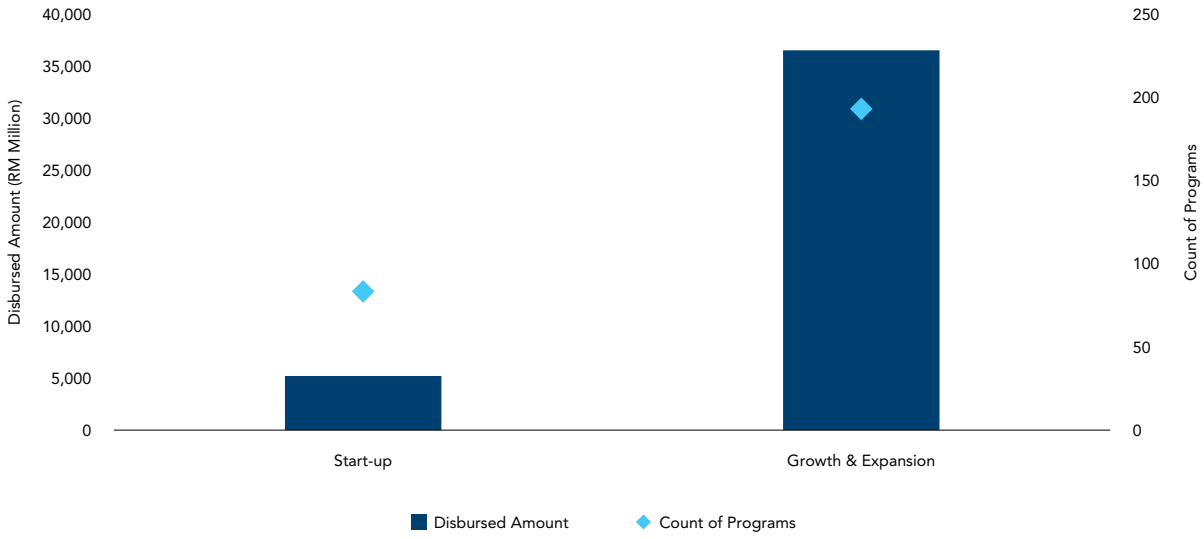
Programs that target the achievement of productivity growth account for the largest share of overall disbursements, followed by programs targeting societal inclusion. Programs that target productivity growth accounted for approximately 67 percent of overall disbursements in the period from 2016 to 2019, mainly driven by large programs that provide access to credit facilities or grants to SMEs (see Figure 55). Furthermore, despite the relatively small number of programs, the disbursement for societal inclusion programs accounted for almost a quarter of overall disbursements within the specified period. This high proportion was largely driven by a single program, the Ikhtiar Financing Scheme, with this one program accounting for approximately 28 percent of the total value of disbursements (approximately RM2.67 billion or US$ 640 million) in 2019 alone. The program was designed to provide interest-free microcredit facilities to assist economically disadvantaged groups by enabling them to invest in income-generating activities or to otherwise engage in entrepreneurial activities. The value of funds allocated to this program is in stark contrast to the allocations for other societal inclusion programs, with the annual disbursement for each program usually amounting to less than RM1 million (approx. US$ 245, 000). These small programs tend to be concentrated in certain areas of the country or are focused on highly specific target beneficiary groups.

Programs by Targeted Business Stages

The programs are largely focused on the provision of support during SME and entrepreneurs' growth and expansion stages. A breakdown by the stage of business or business life cycle that the programs target shows that programs can be divided between two groups, these being programs to support SMEs in the startup and in the growth and expansion stages respectively. The data shows that a significantly larger number of programs, with a higher proportion of total disbursements, were focused on growing and expanding existing SMEs, with more than 190 different programs targeting these enterprises, with total disbursements to a value of RM36.5 billion (approx. US$ 9 billion) in the period from 2016 to 2019 (see Figure 56). These programs aim at growing existing SMEs, in contrast to programs that focus on developing potential businesses at the ideation stages, on facilitating the creation of new businesses, and on growing very nascent businesses. The latter group of programs is classified as 'start-up focused programs,' with programs of this sort numbering just over 80, with total disbursements of RM5.2 billion (approx. US$ 1.3 billion) over the same time period. They generally consist of programs that facilitate the education and training of entrepreneurs or SMEs during the early stages of the business life cycle and the process of expansion, and on the provision of financial support to start businesses or to scale up in the early stages of the business cycle. As seen in the previous section, the policies and programs have recently tended more towards facilitating entrepreneurship at the national level, with an approximately 37 percent increase in programs targeting entrepreneurship enhancement in the period from 2018 to 2019.

40 Knowledge creation in this context aims at improving knowledge and excellence in research. It does not include business R&D or innovation; both would fall into the broad category of productivity growth instead.

Figure 56: Disbursed Budget and Total Number of Programs by Targeted Stages of Programs (aggregated from 2016 to 2019)



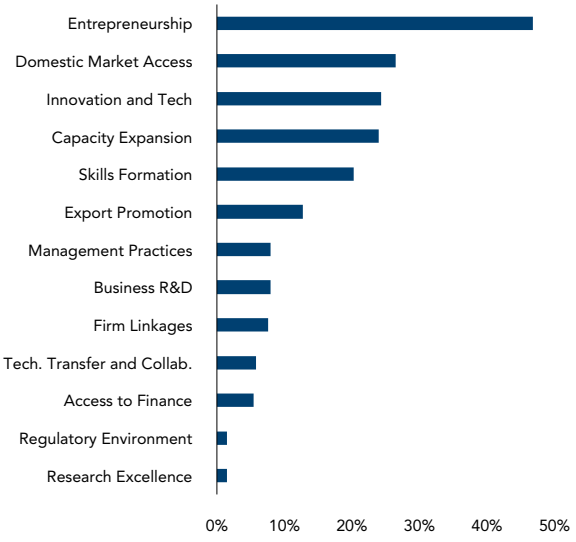
Source: World Bank staff calculations based on SMEIPA data

Despite the focus on the provision of support for firms in the early growth and expansion stages, there have not been major improvements in SMEs' productivity levels, which raises questions regarding the efficacy of the program mix and support. Though SME contribution to GDP and exports have steadily increased over the years, these have not come close to the targets established in the SME Masterplan. Additionally, as seen in the first chapter of this study (and in other studies), the level of productivity of Malaysian SMEs is significantly lower than those in other countries, with declining overall productivity growth rates. With the tremendous amount of support provided by the government to facilitate the achievement of increased growth, expansion and productivity (see Figure 56), productivity growth has not been sufficient to enable Malaysia to catch up with its higher-income counterparts.

Programs by Intermediate Objectives

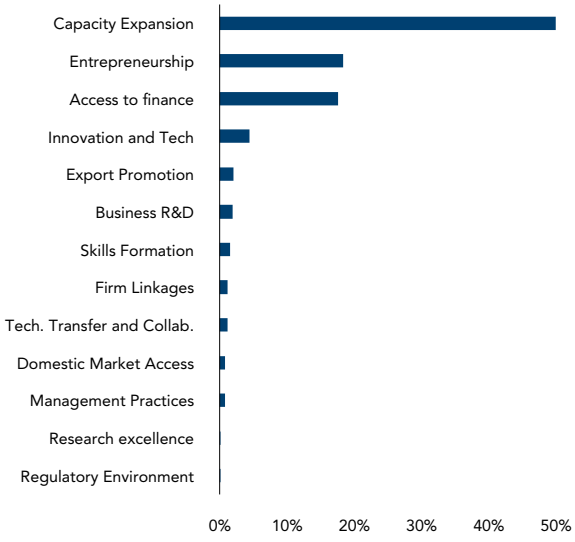
An assessment of the channels through which the economic outcomes are to be achieved shows a wide range of intermediate objectives, with a significant focus on entrepreneurship. Examining the number of programs by intermediate objectives, it can be seen that there is a significant focus on entrepreneurship as a channel to achieve increased productivity growth, improved human capital, and diversification (the main objectives of the government's SME programs, as described earlier), with approximately 47 percent of all the programs utilizing this channel (see Figure 57). These entrepreneurship-focused programs are generally aimed at improving the number of entrepreneurs and the quality of entrepreneurship within the country. The programs include both support for the entry of new businesses and for training and education. This is a more recent focus, due to the increased emphasis on entrepreneurship development mandated by the NEP. In addition to entrepreneurship, the programs are also characterized by a wide range of other intermediate objectives that are intended to facilitate the achievement of the desired economic goals. A substantial number of programs are intended to promote access to domestic markets (26 percent); to increase the involvement of SMEs in non-R&D based innovation and the adoption of new technologies (24 percent); general firm growth or capacity expansion (24 percent); and increased skill formation (20 percent) (see Figure 57).

Figure 57: Share of Programs by Intermediate Objectives (2016 to 2019)



Source: World Bank staff calculations based on SMEIPA data

Figure 58: Relative Disbursement Value by Intermediate Objectives (2016 to 2019)



Source: World Bank staff calculations based on SMEIPA data

The disbursements are concentrated in programs that aim to increase the general capacity of SMEs and entrepreneurs, reflecting the government's target of facilitating the growth of SMEs. Looking at the relative values of programs by each intermediate objective, approximately 50 percent of overall disbursements were allocated for the general capacity expansion of SMEs, largely related to obtaining assets or working capital (see Figure 58). This tends to be related to the general objective of enabling SMEs and entrepreneurs to expand their productive capacity or their businesses more generally, which does not fall in other intermediate objectives.[41] It should be noted that the intermediate objective of "access to finance" in this context differs from the definition used by the government.[42] Nonetheless, programs of this sort account for a significant share of total disbursements, together with programs focusing on entrepreneurship, with both having relative values of approximately 18 percent each. This is not to say that there is a lack of programs with other objectives. The programs that aim to achieve general capacity expansion, improved entrepreneurship, or access to finance tend to be programs that have significantly larger financial outlays compared to others, as they usually provide SMEs and entrepreneurs with some form of financing.

Programs for SMEs that focus on business R&D, management practices, and firm linkages are relatively limited. Programs to support linkages with MNCs, the adoption of management practices and business R&D account for a relatively small proportion of the total number of programs and of the total value of disbursements (see Figures 57 and 58). Nonetheless, these areas of firm support can be critical for the success of SMEs in boosting their innovation and productivity performance. It should be noted that support for management practices refers to programs that explicitly aim to improve the existing management practices of firms through the adoption of measures such as lean management, the formalization of business processes, and others. As such, they may not involve the provision of technical business advisory or technology extension services. Given the acknowledged importance of improved management practice for productivity growth, it appears that these programs are not being sufficiently emphasized to facilitate improvements in this area within firms in Malaysia.

41 These tend to be objectives that aim to further expand the productive capacity of SME or entrepreneurs but does particularly target other intermediate objectives. They are largely comprised of programs that provide general financial support towards SMEs their beneficiaries.

42 In this context, "Access to Finance" involves programs or instruments whose direct objective is to improve access to finance but must have measures to improve the financial market. For a detailed explanation please refer for Appendix 4.

In recent years, there has been a growing impetus towards programs that support digitalization, technology adoption and non-R&D innovation, although this tendency has not necessarily translated into an increase in the value of disbursements for this category. The total *number* of these types of programs has certainly increased in recent years, with the establishment of programs to provide support for the adoption of new emerging technologies, production processes, and other elements that support the emergence of Industry 4.0. However, the total *value of disbursements* for these support programs has remained roughly the same as in previous years. A similar trend can be seen in the case of programs that aim to provide support to enable increased domestic market access,[43] export promotion, and skills formation. However, from 2020, with the advent of the COVID-19 pandemic, the government has placed increased emphasis on programs that support SMEs in their endeavors to digitalize through programs such as the SME Digitalization Grant.

Programs that foster linkages between SMEs and academia are required to address the existing gaps between industry and research. In Malaysia, the lack of collaboration between SMEs and academia has been a persistent problem. Although there are numerous reasons for this, the limited opportunities for collaboration have been at least partly due to the limited technical skills of SMEs, which constrains their ability to adopt new technologies or innovations (World Bank 2020a). Although there are some programs that link SMEs with academia within the SME development program portfolio, these programs are limited in both number and scope. The most prominent of such programs is the Public-Private Research Network, which is intended to identify scientists and experts from local universities who could play a role in the development of technologies for SMEs, with the program also co-financing the development of the technology through grants. However, in recent years this program has received significantly lower levels of funding and served significantly fewer beneficiaries.

Malaysia's SME support program portfolio differs vastly from that of other countries. Malaysia's intermediate objective for the development of SMEs and entrepreneurship is largely focused on the general expansion of firms, together with a number of other objectives, as discussed earlier. Other nations, such as the Czech Republic, have a wider range of objectives than does Malaysia, with a significant focus on non-R&D innovation, entrepreneurship and business R&D (World Bank 2019a). These objectives directly support the intended economic outcomes of productivity growth. In the Philippines, the policy mix tends to focus on skills formation, market access, and management practice (World Bank 2020g). Furthermore, other countries (including the Czech Republic, Vietnam and the Philippines) tend to have programs with more distinct and focused intermediate objectives, such as skills formation and non-R&D innovation, compared to Malaysia, where the programs tend to have more generic objectives. This being the case, there may be a greater need to emphasize targeting as an important principle to be observed in the overall design of Malaysia's programs, particularly in the current economic context and particularly given the government's limited fiscal space.

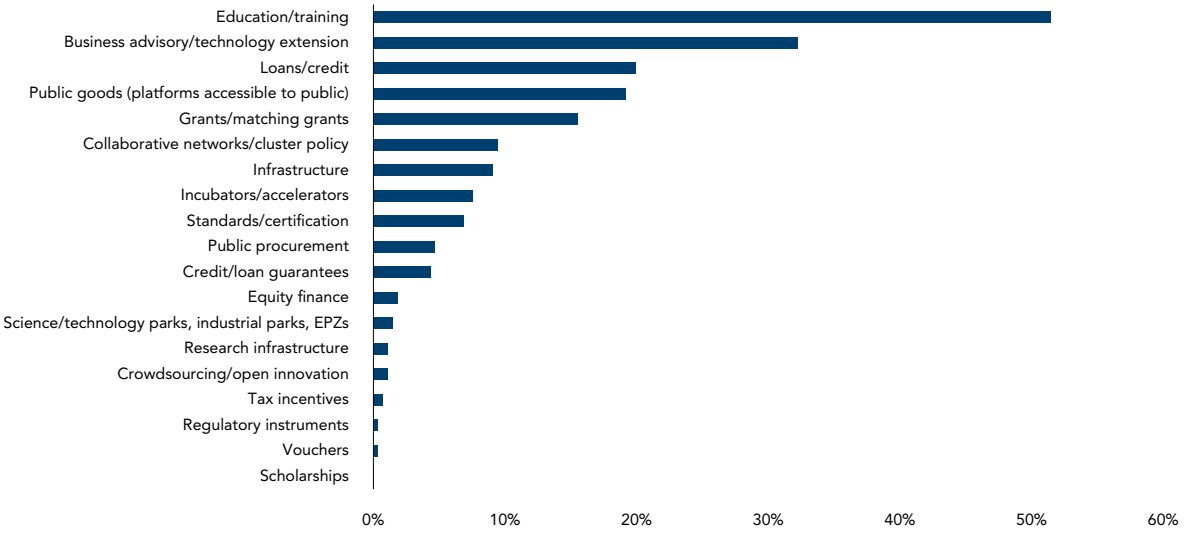
Programs by Mechanisms of Intervention

A large proportion of Malaysia's programs focus on upscaling SMEs through the provision of training and advisory services. Examining the share of programs by their mechanisms of intervention, education and training for SMEs account for more than half of the programs (approximately 51 percent); followed by business advisory or technology extension services (approximately 32 percent) (see Figure 59). The extensive availability of these programs plays an important role in enabling SMEs and entrepreneurs to scale up and adapt to new technologies and innovations to address the lack of absorptive capacity in SMEs to do so (World Bank 2020a). This is in line with the government's broader objective of scaling up SMEs and fostering greater

43 This is to support firms establish and enter into new markets domestically.

entrepreneurship, thus directly supporting the intermediate objectives of the programs. It should be noted that these programs are usually combined with other mechanisms of intervention. A substantial number of programs involve a combination of education, training and/or business advisory, together with additional mechanisms such as financial support (through grants, matching grants,[44] vouchers, equity finance, loans, credits or guarantees), the public procurement of equipment for business operations and others. Thus, these programs involve the provision of multi-dimensional support for SMEs and entrepreneurship.

Figure 59: Share of Programs by Mechanism of Intervention (aggregated from 2016 to 2019)



Source: World Bank staff calculations based on SMEIPA data

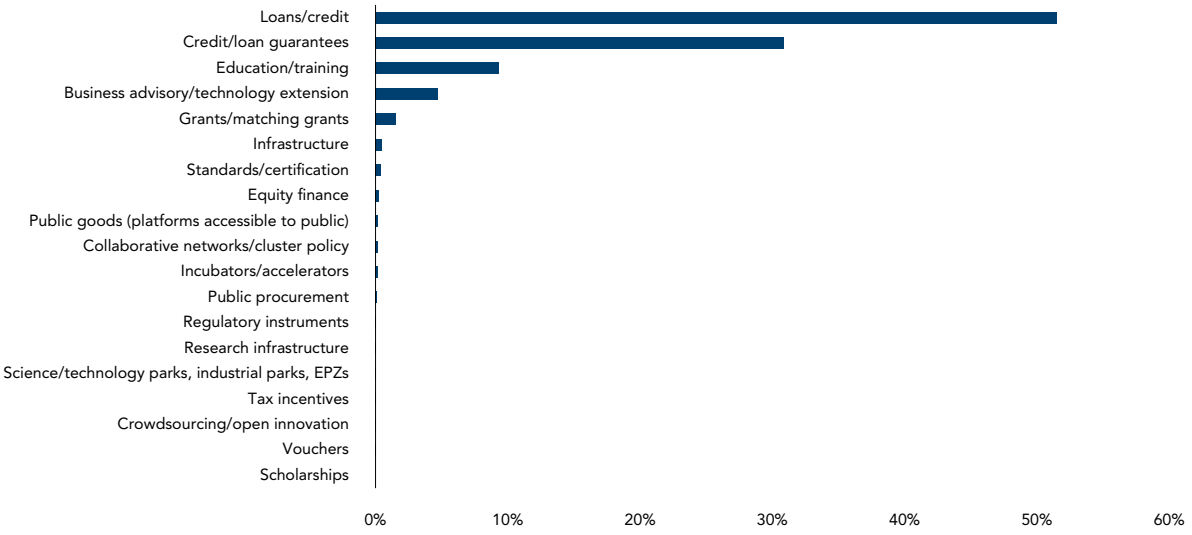
A large proportion of the total value of disbursements is concentrated on programs that provide financial support to SMEs. Approximately 39 percent of the total number of programs implemented in the period from 2016 to 2019 involved the provision of some form of financial support for SMEs and entrepreneurs, including grants, matching grants, vouchers, equity finance loans, credits or guarantees. However, looking at the disbursements by mechanism of intervention, it is unsurprising to find that the proportion of disbursements is higher for programs that provide financial support through such means, as these mechanisms require a larger amount of funding to implement, with loans or credit alone making up approximately half of the value of overall disbursements relative to other mechanisms of action (see Figure 60). The soft mechanisms of intervention (such as business advisory services, education and training programs), while involving a larger share of the overall number of programs, represent only a very small proportion of the total value of disbursements.

Programs intended to facilitate the establishment of linkages between SMEs and MNEs or foreign entities could be further utilized to create greater opportunities for SMEs to access different markets. The linkage programs in the current portfolio of programs are limited. These programs are conducted in various ways, with the most common being through measures to link SMEs to large companies, thereby allowing for the provision of technical assistance and support for SMEs in multiple facets, including increased access to domestic markets. However, most of these linkages programs are concentrated within a few sectors or industries, generally E&E or related manufacturing industries. Additionally, programs to facilitate linkages

44 Grants involves a full subsidy rate whereas a matching grant involved a certain percentage of funding matched by the beneficiary.

between SMEs and foreign entities to promote the integration of SMEs in regional and global value chains are rather limited, with general export promotion programs being relatively more favored than those that promote linkages and partnerships.

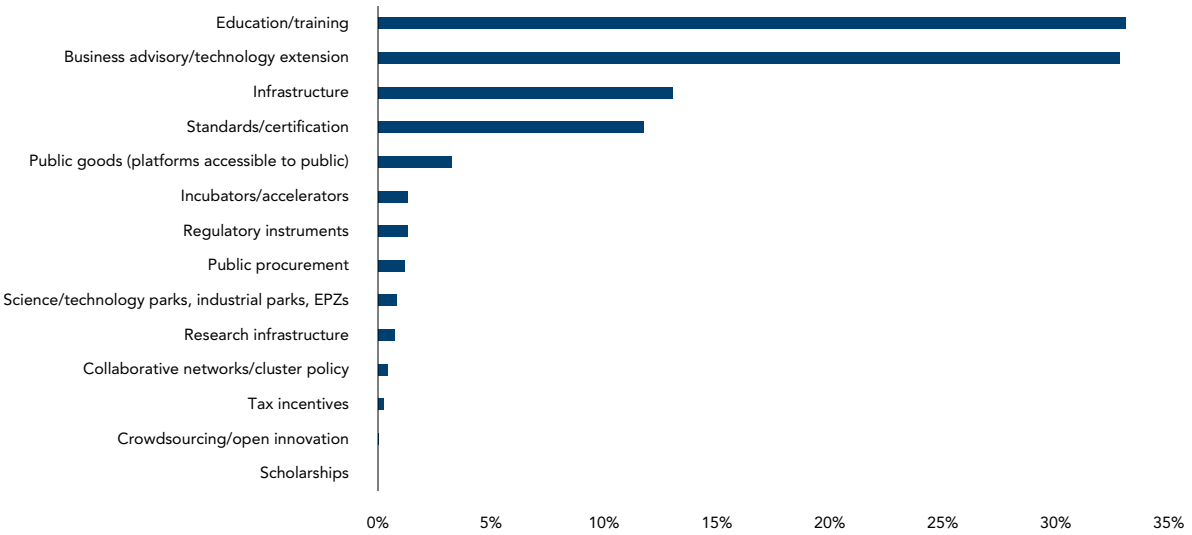
Figure 60: Relative Value of Programs by Mechanism of Intervention (aggregated from 2016 to 2019)



Source: World Bank staff calculations based on SMEIPA data

A significant proportion of disbursements is concentrated within programs that support the provision of technical assistance and infrastructure. Soft mechanisms of intervention largely involve education and training for SMEs and business advisory and technology extension services. Excluding the programs that involve the use of financial support mechanisms, education and training as well as business advisory support programs account for approximately two-thirds of the total value of disbursements (see Figure 61). A significant

Figure 61: Relative Value of Soft Programs by Mechanism of Intervention (aggregated from 2016 to 2019)



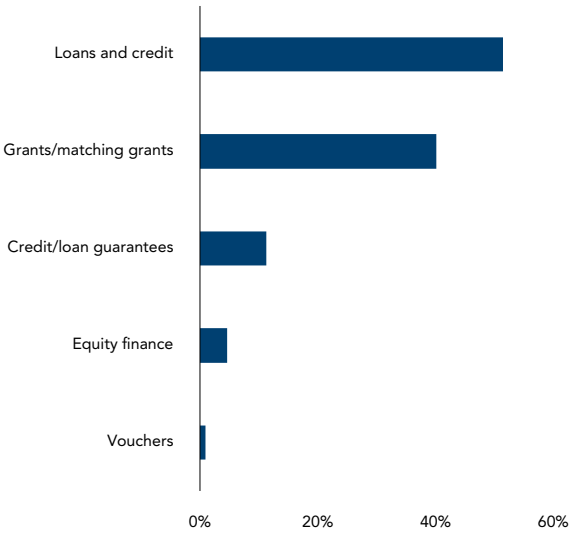
Source: World Bank staff calculations based on SMEIPA data

proportion of disbursements is also concentrated on programs that support the provision of infrastructure, which account for approximately 13 percent of total disbursements. Programs of this sort generally involve the provision by the government of some form of infrastructure to benefit SMEs or entrepreneurs, such as business premises or other facilities. These programs are usually concentrated in states or cities outside of the Klang Valley and in the rural areas. Furthermore, the government also provides significant support to enable SMEs to meet specific standards and to obtain certifications in order to enhance their competitiveness. The certifications relate to a wide range of standards or activities, including those that relate to high-technology uptake for the development of products that meet specified quality standards.

Programs Involving Financial Support

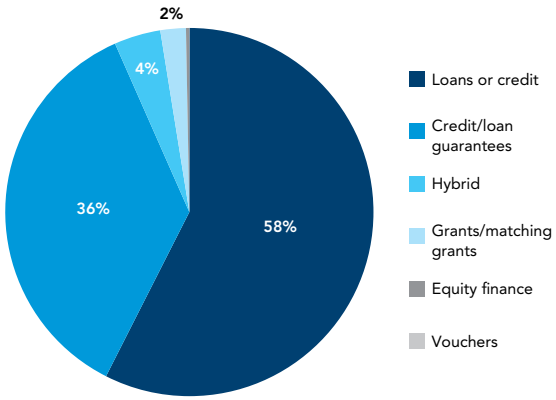
The government's financial support programs for SMEs largely involve the provision of loans or credits to SMEs and entrepreneurs. Amongst the programs that provide some form of financial support, approximately 51 percent provide some form of loan or credit, followed by programs that provide grants or matching grants, which account for approximately 42 percent (see Figure 62). A small number of programs (nine in total) involve mixed (or hybrid) financial support mechanisms, with each of these programs providing more than one mechanism of support. For instance, some programs provide their beneficiaries with an initial grant, followed by a loan at a fixed financing rate. Other mixed financial support programs offer equity finance and loans, or credit guarantees paired with loans. Loans and credits account for the largest proportion of the total value of disbursements for financial support programs, at approximately 58 percent, followed by those that provide credit or loan guarantees, at 36 percent (see Figure 63). Although programs that provide credit or loan guarantees constitute a relatively small number of the support programs compared to those that provide grants or matching grants (see Figure 62), they account for the lion's share of the total value of disbursements (see Figure 63).

Figure 62: Share of Financial Support Programs (aggregated from 2016 to 2019)



Source: World Bank staff calculations based on SMEIPA data

Figure 63: Share of Disbursements for Financial Support Programs (aggregated from 2016 to 2019)

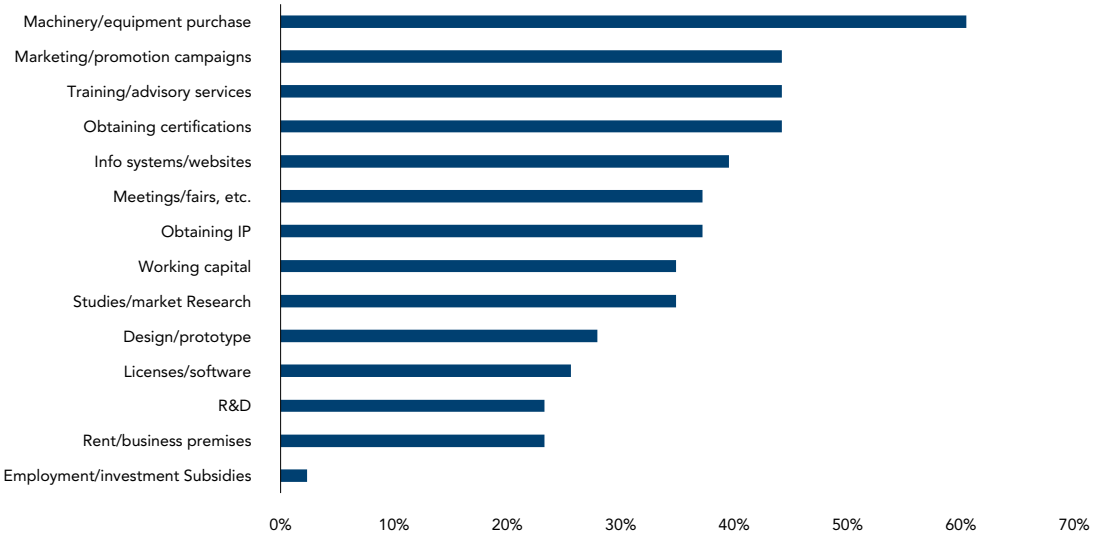


Source: World Bank staff calculations based on SMEIPA data

Financial support programs that involve the provision of grants are used in a variety of different ways, although most of them focus on financing firms' operations. These programs provide loans and credits that are typically used to finance working capital or large asset purchases (premises, machineries, equipment, or other fixed assets). In the case of sixty percent of these programs, grants were also typically used to enable SMEs to obtain new machinery or equipment, which may be problematic, as these could constitute an asset that could be repossessed (see Figure 64). This is followed by programs that provide other advisory and operational support activities, including those related to marketing and promotion, training or advisory services and obtaining certifications (a combined total of 44 percent). Most of these programs aim to upscale SMEs by enabling them to acquire more effective factors of production and technologies and to improve their capacities to achieve greater productivity gains. Programs that provide funds for marketing or promotional activities are intended to enable Malaysian SMEs to increase the export of their goods and services in order to achieve greater diversification.

Programs to promote R&D, especially at the earlier stages of the innovation cycle, may require grants as a form of support. The high risk of failure at the early stages of the life cycle of innovative firms justifies stronger forms of government intervention. As discussed in the previous section, while there are some programs that support R&D for SMEs in the overall portfolio, they are dwarfed by general programs to support business growth (see Figure 64). Additionally, programs that focus on innovation and technology tend to be concentrated on enabling SMEs to acquire new technologies, rather than supporting SMEs to actively engage in R&D. It should be reiterated that programs supporting R&D in Malaysia generally target academia or public research institutions, rather than SMEs.

Figure 64: Share of Programs by Grant Usage (Percentage of total programs involving grants)



Source: World Bank staff calculations based on SMEIPA data

Beneficiary, Sectoral and Regional Programs Analysis

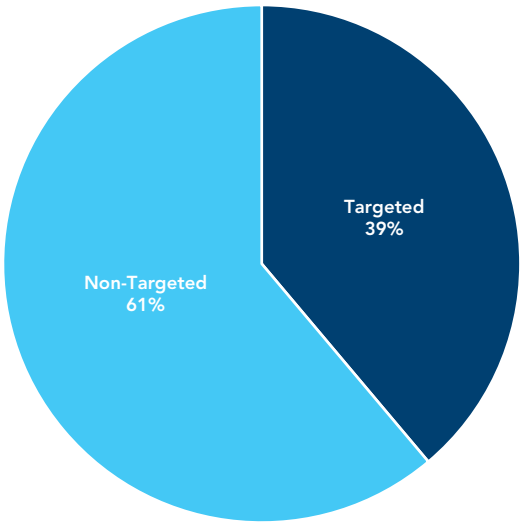
The large number of SME support programs and the differences in their mechanisms of intervention lead to significant variations in the average value of disbursements per beneficiary. The value of the disbursement per beneficiary generally depends on the mechanism of intervention, the beneficiaries targeted, and the activities supported by the programs. For instance, programs that provide financial support for SMEs and entrepreneurs have an average disbursement per beneficiary of approximately RM1.6 million (approx. US$ 390,000), although the median value is around only RM120 thousand (approx. US$ 29,000).[45] The average tends to be skewed by certain programs that involve particularly high cost activities, such as the acquisition of new technologies and large assets. In fact, most of these programs are concentrated at the lower end in terms of the value of disbursements per beneficiary. Unsurprisingly, programs that employ soft mechanisms have significantly lower disbursements per beneficiary, at an average of approximately RM 90 thousand (approx. US$ 22,000) per beneficiary (inclusive of support such as technical assistance) and a median of RM2 thousand (approx. US$ 487) per beneficiary. These observed differences are not unexpected. In addition, knowledge embedded in assets (machines) is more appropriable by the private sector than knowledge embedded in people, which can promote increased spillovers. Thus, the former should be paid for by the user (loan) while the latter has more of a character of a public good, and thus its subsidization can be justified (grant).

While the majority of SME and entrepreneurship development programs are targeted towards formal firms, programs targeting individual entrepreneurs are also significant.[46] In proportion to the total value of disbursements, programs that targeted formal firms accounted for approximately 74 percent in the period from 2016 to 2019. Overall, these programs generally have a broad target of beneficiaries, but mostly including businesses that can be classified as SMEs. Programs targeting individual entrepreneurs are also significant, accounting for approximately 24 percent of overall disbursements in the period from 2016 to 2019, with about one-third of the total number of programs open to individual entrepreneurs. Most of these programs involve the provision of education or training to individuals who hope to upskill to enter or improve their position in the workforce or to embark on entrepreneurial endeavors, but who have not yet registered their businesses with the relevant authorities.

The beneficiary groups targeted by Malaysia's SME development programs often extend beyond the categories of beneficiaries provided with support elsewhere. Targeted programs accounted for about 39 percent of the total value of disbursements in the period from 2016 to 2019 (see Figure 65).[47] These programs aim to increase the participation of entrepreneurs and firms from specific target groups, such as members of B40 households, Bumiputeras, women or households and residents of rural and remote areas. A large proportion of these targeted programs are intended to benefit households in the B40 category, with a large proportion of disbursements for this category of program driven by one program, as described above (Figure 66 shows the disbursements for targeted programs). If that program were excluded, the value of disbursements for programs intended to support the B40 would be at the same level as those to support youth and rural residents. This means that the value of disbursements for Bumiputera-exclusive programs also make up a substantial share of the overall total, with approximately RM6 billion (approx. US$ 1.2 billion) in disbursements in the period from 2016 to 2019. Youth and rural exclusive programs are comparatively smaller (both at around RM100 million,

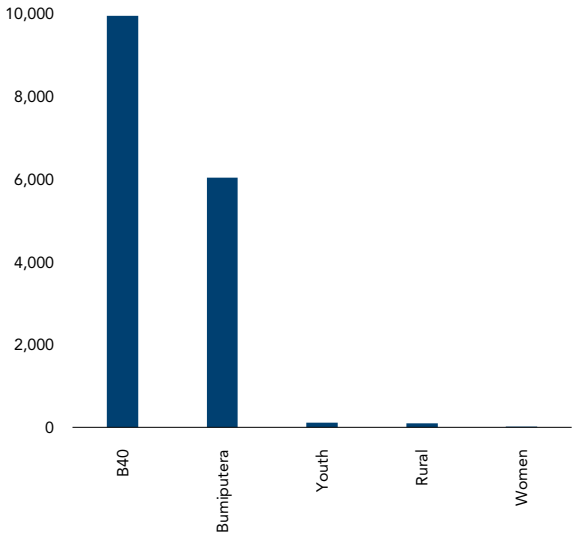
45 These are only for programs where data for both beneficiaries and disbursements are available.
46 Formal firms refer to firms that are registered with the Companies Commission of Malaysia (SSM) or any other professional bodies including local authorities regardless of size, sector or industry.
47 Non-targeted programs are open for most beneficiaries and are not subjected to meeting specific criteria of entrepreneur or firm ownership. The targeted programs on the other hand cater to specific beneficiaries only.

Figure 65: Proportion of Disbursements for Programs with Targeted Criteria (2016 to 2019)



Source: World Bank staff calculations based on SMEIPA data

Figure 66: Total Disbursements for Programs with Targeted Criteria (2016 to 2019) (RM Million)



Source: World Bank staff calculations based on SMEIPA data

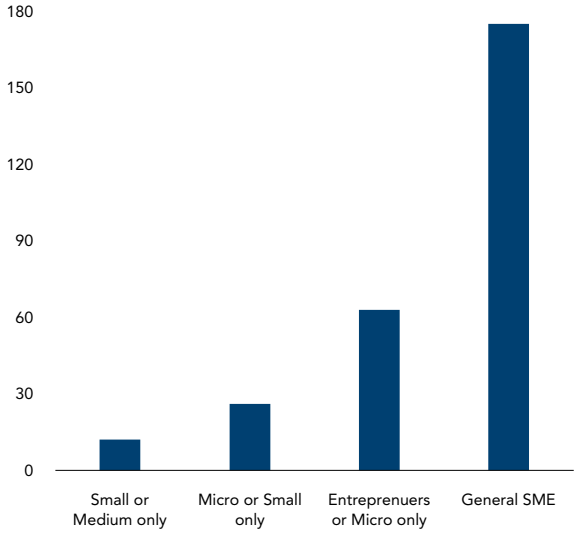
or approx. US$ 25 million) than those that target the B40 or Bumiputera, with programs that target women or women-owned businesses even smaller (less than RM20 million or approx. US$ 5 million). However, it should be noted that there are numerous programs that are open to all types of beneficiaries and may have selected schemes for women, youth or rural firms/entrepreneurs.[48]

Most SME development programs do not target SMEs in particular size categories, with the majority of SME programs open to SMEs of all sizes, including microenterprises. This holds true for both the total number of programs and the value of disbursements (see Figure 67 and Figure 68). Programs that are open to all SMEs accounted for approximately 70 percent of the total value of disbursements in the period from 2016 to 2019, followed by programs that target microenterprises and entrepreneurs, at 24 percent. Amongst the programs that cater to all SME sizes, most have different requirements or eligibility criteria for firms in different size categories. These include metrics related to sales performance, liquidity levels, or other relevant metrics that complement the differences in terms of the actual benefits firms receive and the agreements made by these firms with the implementing agencies. The sizable proportion of disbursements for programs that support the development of microenterprises (see Figure 68) is a further indication of the Malaysian government's commitment to support microenterprises, rather than startups. These programs aim to assist individuals and entrepreneurs through the provision of training support or education and some financial support (through microcredit or small grants) to enable them to establish their own businesses.

The majority of the SME development programs are open to all sectors and hence are sector agnostic. For the period under consideration (2016-19), 129 of 275 programs are sector agnostic (see Figure 69). A similar trend is apparent for the share of disbursements, with sector-agnostic programs accounting for more than 80 percent of the total value of disbursements (approximately RM 33.6 billion or US$ 8.2 billion) in the period from 2016 to 2019 (see Figure 70). Programs targeting SMEs in either the manufacturing or services sectors account

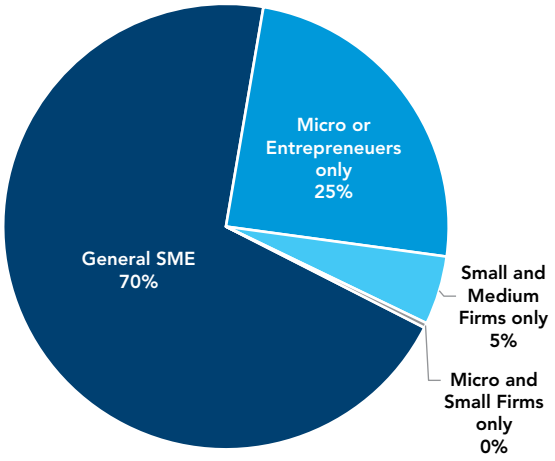
48 The limited range of data for this study would not allow for a deep dive and scrutinize the actual number of beneficiaries or disbursement for each individual target group.

Figure 67: Number of Programs by Targeted Firm Size (aggregated from 2016 to 2019)



Source: World Bank staff calculations based on SMEIPA data

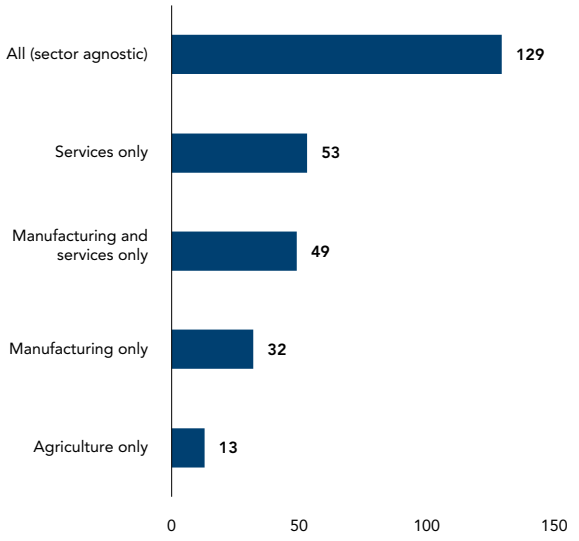
Figure 68: Share of Disbursement by Targeted Firm Size (aggregated from 2016 to 2019)



Source: World Bank staff calculations based on SMEIPA data

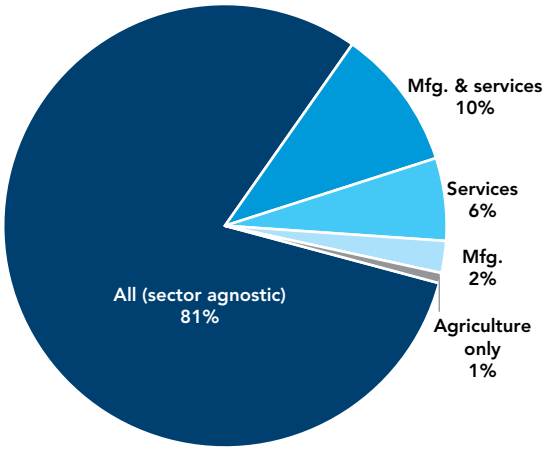
for 10 percent of this total value, with programs targeting services only and manufacturing only accounting for approximately six percent and two percent of the total value of disbursements respectively. The agricultural sector accounts for the smallest number of programs as well and the smaller share of total disbursements, accounting for 13 programs and approximately one percent of disbursements (approximately RM310 million) within the same time period.

Figure 69: Number of Programs by Sector Focus (aggregated from 2016 to 2019)



Source: World Bank staff calculations based on SMEIPA data

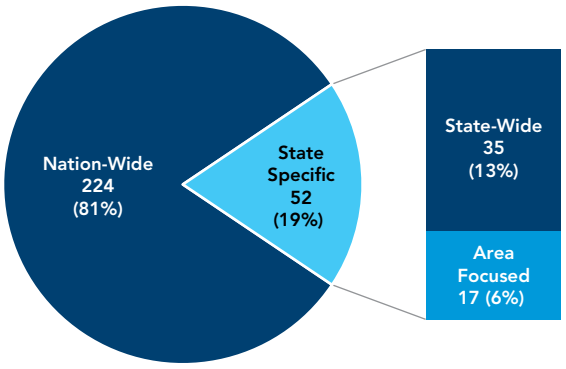
Figure 70: Share of Disbursement by Sector Focus (aggregated from 2016 to 2019)



Source: World Bank staff calculations based on SMEIPA data

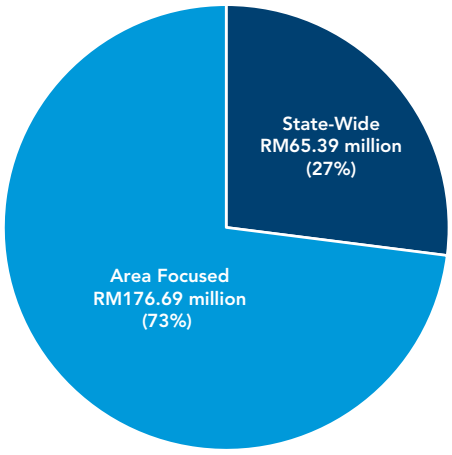
State-focused development programs, intended to promote the development of SMEs in a particular state, account for a small proportion of the total number of programs and an even smaller proportion of disbursements.[49] In the period from 2016 to 2019, state-focused programs accounted for 52 programs, or 19 percent of the total programs (see Figure 71). In terms of disbursements, the state-specific programs account for less than one percent (approximately RM242 million or US$ 59 million) of the total disbursements in the same period. State-specific programs can be further divided into programs that are state-wide or that are focused on specific areas within states (area-focused programs), with the former accounting for most of the programs in this category. State-wide programs refer to programs that are available to any otherwise qualified applicant in any location or area in the respective state. On the other hand, area-focused programs refer to programs that are cover only a specified area, town or zone within a state. Area-focused programs constitute almost three-quarters of all state-specific disbursements (see Figure 72). This is attributed to the nature of the programs, with area-focused programs largely composed of area development projects that focus on the development of infrastructure, with these programs tending to be larger.

Figure 71: Share of Programs by Geographical/State Focus (aggregated from 2016 to 2019)



Source: World Bank staff calculations based on SMEIPA data

Figure 72: Share of Disbursement for State Specific Programs (aggregated from 2016 to 2019)



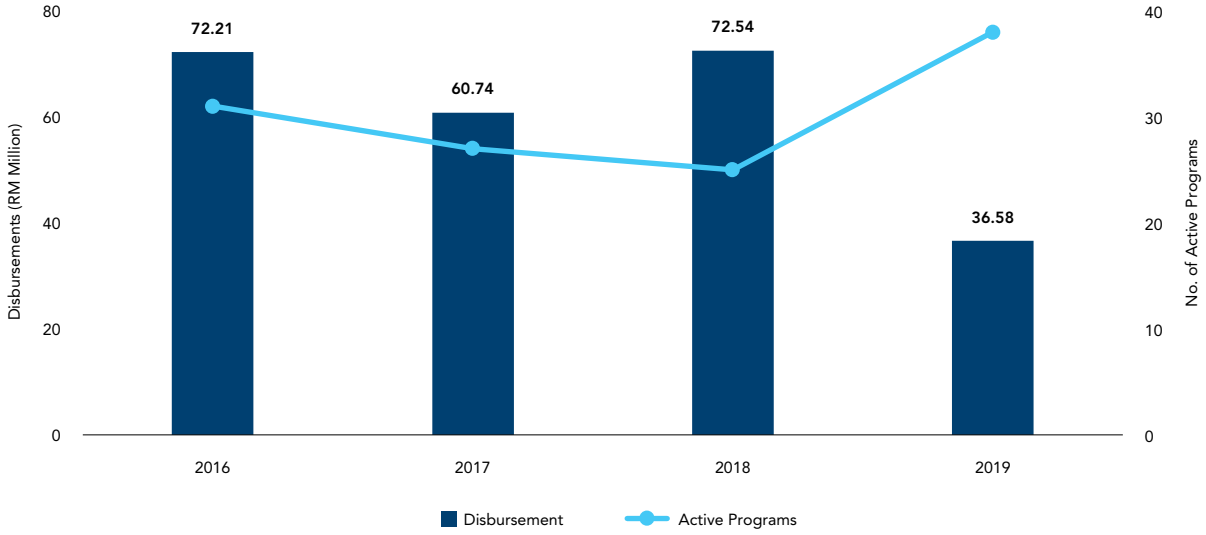
Source: World Bank staff calculations based on SMEIPA data

As was the case for national level programs, there was also a drastic decrease in the value of disbursements for state-specific programs in 2019, despite an increase in the number of these programs. In 2019, the number of state specific programs increased to its highest level in recent years, going up from 25 programs in 2018 to 38 programs in 2019 (see Figure 73). However, the increase in the number of programs was accompanied by a decrease in the total and average value of disbursements. In 2019, the funds disbursed for state-specific programs fell to its lowest point in recent years, at RM36 million (approx. US$ 9 million), a decrease of almost 50 percent from the figure in the previous year. This was partly attributable to the decrease in infrastructure projects (construction or upgrading of business premises) following the completion of a number of such projects. It should also be noted that the additional programs introduced in the period

49 The lack of spatial information and data for the SME development programs would not allow for an in-depth analysis on the concentration of programs around Malaysia or the concentration of beneficiaries.

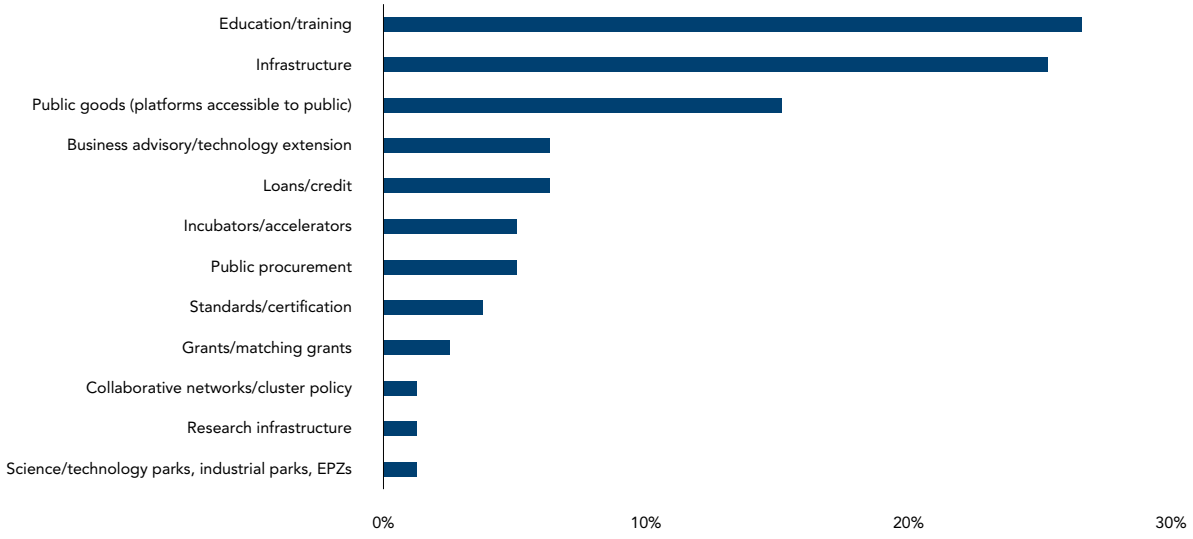
from 2018 to 2019 were largely focused on providing support related to human capital development and market access for SMEs. Such programs tend to have soft mechanisms of intervention (pertaining to the provision of business advisory services, education and training for SMEs and to facilitate the establishment of firm linkages), which require relatively smaller disbursements for firms (see Figure 74).

Figure 73: Evolution of Active Programs and Disbursement for State Specific Programs (2016 – 2019)



Source: World Bank staff calculations based on SMEIPA data

Figure 74: Share of Programs by Mechanism of Intervention for State-specific Programs (aggregated from 2016 to 2019)



Source: World Bank staff calculations based on SMEIPA data

State-specific programs are generally concentrated in East Malaysia and in the northern states of Peninsular Malaysia. Over the period from 2016 to 2019, Sabah was the state with the largest number of programs of this sort, with 20, followed by Sarawak and Kelantan, with 10 and eight different programs respectively. In terms of total disbursements, Sarawak accounted for the greatest proportion, at RM84.33 million (approx. US$ 20.5 million), followed by Sabah and Johor, at RM63.71 million (approx. US$ 15.5 million) and RM42.05 million (approx. US$ 10.2 million) respectively. Programs specific to Sabah and Sarawak are typically implemented by state government agencies, while the programs for the states in Peninsular Malaysia are typically implemented by agencies under one of several federal ministries (most commonly the Ministry of Rural Development, and the Prime Minister's Department, formerly the Ministry of Economic Affairs). In aggregate, states with higher overall and average disbursements tend to implement programs that are focused on infrastructure, including the construction of business premises, with projects of this type driving up the value of the disbursements. A significant number of programs also focus on the provision of advisory services and training for SMEs (see Table 5).

Table 5: State Specific Programs and Disbursement by State (aggregated from 2016 to 2019)

	Number of Programs	Disbursement (RM Million)
Sarawak	10	84.33
Sabah	20	63.17
Johor	2	42.05
Kelantan	8	35.41
Kedah	4	9.44
Terengganu	2	4.50
Melaka	1	2.80
Penang	5	0.37

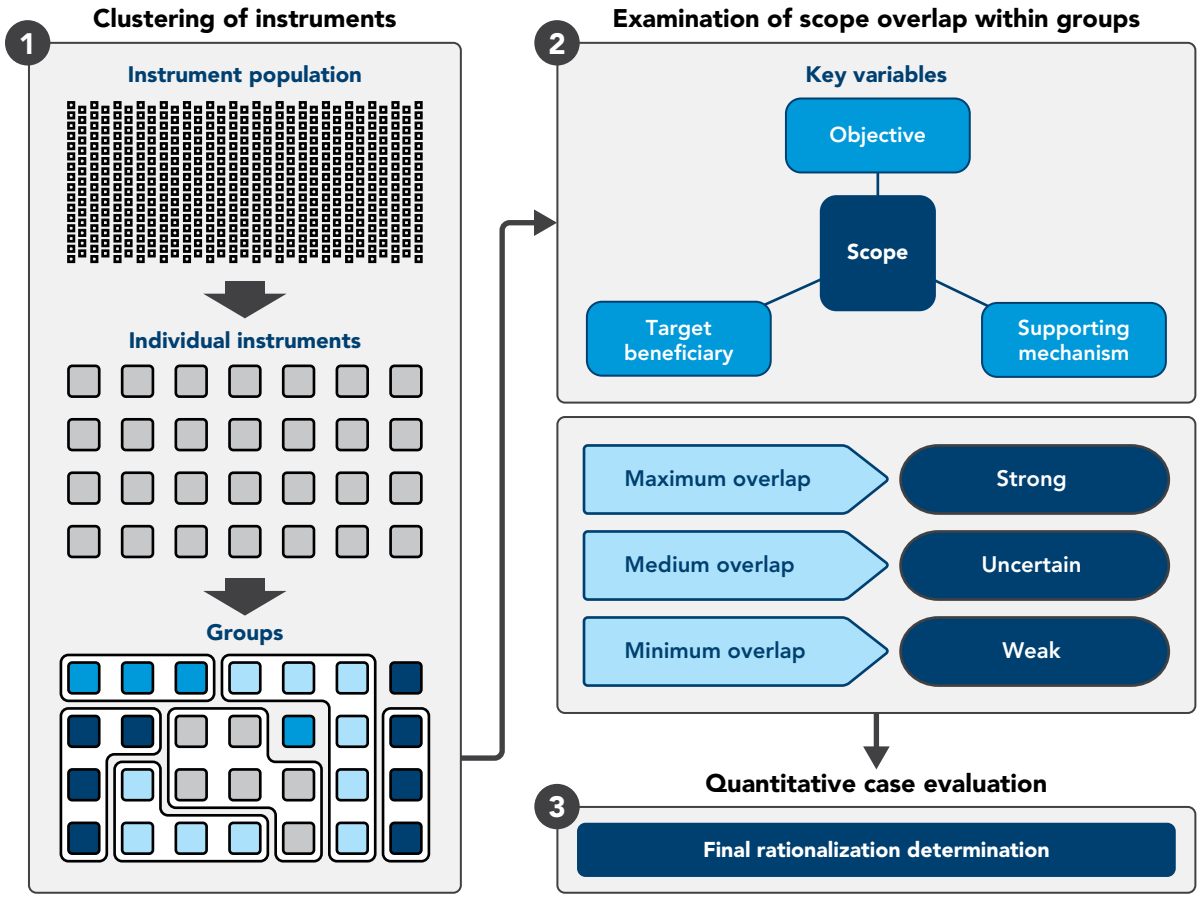
Source: World Bank staff calculations based on SMEIPA data

Cluster Analysis

When there is a large number of programs involving a wide range of agencies and entities, it is to be expected that there will be a certain degree of duplication and overlap between the programs. This can result in redundancies and inefficiencies, suggesting that there is a potential opportunity to rationalize resources and instruments. A thorough examination of the portfolio to identify these opportunities may lead to efficiency gains, possibly achieved through the elimination or merging of programs. It may also facilitate more effective targeting, enabling policymakers to sharpen the focus of existing programs.

To investigate potential redundancies, a cluster analysis has been conducted to identify the underlying structures of the programs. Objectives, supporting mechanisms and target beneficiaries were selected as the variables for running the clustering, considering the significance of their role in defining the scope of the instrument, methods of intervention, their relationship with certain market failures and solutions to address the problems. Figure 75 describes the methodology for identifying potential redundancies.

Figure 75: Framework for Conducting the Clustering Analysis



Source: World Bank staff illustration

The framework defines three proxy variables to lay out the scope of the programs' overlaps. These include the program objectives, program beneficiaries and mechanisms of intervention.

i. **The analysis relied on a cluster analysis to create measures of similarity between pairs of objects, using these variables.** The cluster analysis assigns instruments into groups (by similarity of scope). We used this segmentation to look closer at each group of instruments to identify potential cases that present overlapping scopes.

ii. **The findings of the cluster analysis warrant additional examination of these cases to explore potential integration or consolidation of programs depending on the degree of overlap.** Strong is an overlap of 3 variables; uncertain or moderate is an overlap of 2 variables; and not applicable is an overlap of 1 variable or less.

iii. **Finally, qualitative scrutiny was undertaken to validate some of the assumptions based on context and detect any nuanced issues.**

It should also be noted that to avoid any redundant analyses, this cluster analysis has only been conducted for programs that were active in 2019.

In brief, the analysis showed that a considerable number of programs overlap, with the differences between many of these programs being very nuanced. Most of the programs tend to have very similar objectives and mechanisms of intervention. At face value, these scenarios may present a strong case for consolidation and justified further analysis, with the nuanced differences providing explanations as to why such scenarios arise. This section will focus on some of the key findings from the cluster analysis, highlighting some of the distinct features of the Malaysian SME program portfolio. (Further details regarding the methodology can be found in Appendix 5: Cluster Analysis).

In Malaysia, a large number of SMEs support programs have similar scopes and mechanisms of intervention, with the differences between them very slight and nuanced. In many cases, different programs have exactly the same objectives and mechanisms, with the only differences between them relating to the beneficiaries they target, the sector targeted, or the specific types of activities the firms are engaged in. Thus, several otherwise very similar programs may be distinguished only by the fact that one may target only Bumiputeras, and another targets newly established SMEs, whereas the third could be open to any SMEs.

Monitoring and evaluation mechanisms vary across programs and between different implementing agencies. Given the large number of programs and the involvement of a wide range of different stakeholders from diverse agencies and entities, mechanisms to monitor and evaluate the performance of SME programs can vary greatly between different programs. This makes it challenging to link programs to their intended outcomes and to otherwise assess their performance. In the case of some programs, the outcome indicators are interlinked with the performance of all programs used to provide end-to-end assistance. However, certain programs do not have sufficient data to conduct M&E in a coherent, evidence-based manner (World Bank 2020e). Inadequate monitoring and evaluation frameworks and reporting practices prevent impact evaluations from being conducted effectively or at all. Although most programs do collect a range of data on beneficiaries, this data is largely retained at the program level, with a limited level of detail or depth. These data may not always be properly stored or digitized, let alone systematically collected and shared across the different implementing agencies and ministries involved. A systematic collection, storage and analysis of this data could play a vital role in providing important, reliable information that could serve as inputs for future budget allocation processes or decisions, enabling the more efficient allocation of resources.

Major inconsistencies in reporting arise when the programs are clustered. Certain programs are segregated to account for subtle differences in their components, while other programs aggregate seemingly different activities with diverse scopes into a singular program. It is important, therefore, to consider a means to develop a consistent and coherent system of classifying programs across ministries and agencies, as this would enable a more systematic overview of the various programs, while at the same time enabling an accurate differentiation between them.

The analysis shows that there are overlaps in program objectives and instruments across ministries and agencies. As discussed earlier, a wide range of different ministries and agencies are involved in the implementation of the SME and entrepreneurship development programs across Malaysia, covering a wide range of activities and beneficiaries. Overlaps and duplications across ministries and agencies are the results of programs having very similar generic objectives and mechanisms of intervention, with different programs for very narrowly defined areas, related to specific economic activities or specific beneficiary groups. This pattern was highly characteristic of Malaysia's SME support portfolio, with a complete list of these programs provided in Appendix 5.


Handrodplast
Rasa

CHAPTER 3

Policy Coherence and Recommended Areas for Policy Actions

In order for Malaysia to boost SME productivity and thereby to enable SMEs to make a greater contribution to the achievement of Malaysia's development aspirations, it is essential to address both firm-level binding constraints and broader structural issues. In order to benefit from economic growth in an effective and inclusive manner, lagging firms (mostly SMEs) must converge towards more productive firms (which are often large or foreign-owned). In the context of dramatic global economic transformation driven by factors such as increased digitalization and the emergence of new technologies and the changing nature of work, both of which tendencies have intensified since the pandemic, Malaysia's SMEs will face increasingly significant challenges and disadvantages unless they are provided with the support and resources they need to adapt and succeed.

This chapter offers a set of recommendations to serve as inputs to enable policymakers to improve the coherence and efficacy of Malaysia's SME policy mix. The evaluation assesses the coherence between the key factors affecting SMEs (from the Country Needs Analysis), the country's SME development priorities, and the composition of the policy mix. This analysis examines the degree of equivalence between challenges and measures to determine whether the instruments effectively respond to the most significant challenges that constrain business innovation, particularly by SMEs, including in the presence of market failures. This analysis is set within the context of the policy framework priorities. It also attempts to identify gaps that are currently not appropriately covered by existing programs.

Organization, Management and Redundancies of Programs

With overlaps between the SME support programs across the wide range of ministries and agencies that implement them arising due to the proliferation of programs with very similar objectives, there is a need to strengthen coordination across ministries and to streamline programs to improve their efficiency and effectiveness. To identify opportunities to achieve improved efficiency, a redundancy analysis has been conducted to investigate potential redundancies in the policy mix. The analysis shows that a considerable number of programs overlap with each other, with very nuanced differences between them. In total, the analysis revealed 11 possible cases to consider, involving 30 programs. Overlaps across ministries and agencies arise due to programs having very similar, generic objectives. The analysis supports the case to strengthen coordination across ministries and agencies and to streamline the number of programs in operation. The present crisis creates an opportunity to carefully examine the needs of the SMEs and to recalibrate support programs so that they effectively meet these needs. In doing so, a consistent effort needs to be made towards the effective use of the data to inform future policy making. An overarching strategic and policy framework that governs SME development, akin to an SME Masterplan, could play a powerful positive role in improving the design, implementation and coordination of Malaysia's SME support programs.

RECOMMENDATION 1: Enhance governance around SME development, reporting, data management and transparency of programs by implementing agencies.

Given the number of agencies and ministries involved in SME development, there is a need to strengthen the governance structure to have a strong apex organization that has the convening power to bring together the various initiatives under a coordinated mechanism. To be effective, the mandate/mission of this apex body such as SME Corp needs to be aligned to the overall SME development objectives for Malaysia and needs to be clearly understood by all stakeholders involved. Previously, World Bank (2020e) also argued that the governance of an independent SME Corp through the NESDC will continue to be an important platform for policy decisions on SME development and implementation of the SME Masterplan.

At present, there is no standard way of defining the programs from the SMEIPA to report on their achievements, with a lack of separation between programs and activities in some cases. This makes it hard for policymakers to conduct a meaningful program efficiency analysis. The cluster analysis also revealed a number of significant disparities in the reporting practices for different programs within the portfolio. Some programs are separated into different categories to account for subtle differences in their components and activities, whilst other programs aggregate seemingly very different activities with diverse scopes into a singular program. It is also important to consider the means by which the transparency and data availability related to the SME programs could be improved, including through breakdowns of fund transfer mechanisms and data that enable a clear assessment of how funds are utilized for each program.

Detailed program information is also essential to enable an effective analysis of the reach of the programs so as to facilitate more effective targeting, particularly including information that provides a full breakdown of beneficiaries (by size or different target groups) and of budgets and expenditures at the program level. Information related to these programs should be made more widely available to achieve greater transparency and accountability. Weak monitoring systems and reporting practices prevent effective impact evaluations from being conducted, which in turn constrains future policy making. A more robust monitoring system should also be applied to the budget allocation process for these programs. In addition, a model of budget allocation that rewards programs that provide effective coordination and end-to-end facilitation to address key constraints to SME growth and competitiveness will be key to successfully creating a more coordinated approach to SME development.

RECOMMENDATION 2: Consider merging programs that have considerable overlaps in objectives, mechanisms, and beneficiaries to avoid redundancies and to eliminate programs that are too small to be effective.

The cluster analysis shows that a large number of Malaysia's SME support programs are characterized by redundancies and overlaps. Based on the results of this cluster analysis, a thorough re-evaluation of the current portfolio of SME and entrepreneurship development programs should be conducted to identify programs for which further action may be required. Additionally, this process may enable the rescaling of certain small programs that may not be effective due to their relatively small scale.

Building Capabilities and Leveraging Productivity-improving Technologies

The current crisis creates an opportunity for the government to recalibrate its programs to promote private sector growth on the basis of the identified needs of SMEs. Over the years, the Malaysian government has introduced, implemented, and reformed numerous instruments and programs to support a wide variety of SME activities. With new programs being designed to expedite the recovery of the private sector, there is an opportunity to recalibrate program support towards priority areas, such as through initiatives to build the digital capabilities of SMEs to increase private sector growth and resilience. Other areas of support could include measures to increase SME capabilities to produce environmentally sustainable products. With increasing attention being given by large multi-national corporations (MNCs) to compliance with environmental, social and corporate governance (ESG) standards, these support measures for SMEs could enable them to successfully integrate into reconfigured global value chains (GVCs) that require compliance with these ESG standards. In the design of these programs, the establishment of linkages with the private sector could play a pivotal role in facilitating feedback mechanisms that inform policy design and implementation.

RECOMMENDATION 3: Recalibrate SME programs to support SME digitization.

The BPS survey conducted in February 2021 found that while some firms did make investments in digital solutions, many were constrained by limited access to finance from doing so, with this being the most commonly cited reason for not making such investments, followed by a lack of information and lack of certainty regarding the benefits to be derived from these investments. Further, the rates of investments were largest in the larger firms, followed by medium-sized firms. While the most common use of digital platforms relates to sales and marketing, there has also been significant adoption of digital technologies to facilitate more complex functions, such as production and supply chain management, by large firms. The government has articulated Malaysia's aspirations to achieve the successful transformation of the country into a digitally-driven, high-income nation and the regional leader in the digital economy through the *MyDigital* Blueprint. For the government to facilitate the achievement of these aspirations, it needs to promote the increased uptake of more complex technologies in order to enable SMEs to achieve productivity dividends. In fact, despite the already high proportion of firms that have adopted digital technologies, the vast majority of firms (90 percent or more of those surveyed) stated that they would benefit from government assistance to promote the increased adoption and uptake of digital solutions, to mitigate the negative impacts of the COVID-19 crisis.

RECOMMENDATION 4: Rebalance the policy mix

Looking at Malaysia's current SME support policy mix, it can be seen that most programs are primarily focused on providing support during the growth and expansion stages of SMEs, with programs of this sort accounting for 87 percent of the total value of program disbursements. While the government has recognized the need to rebalance this through the introduction of programs that focus on the earlier stages of the business cycle, the program mix should also focus on measures to enable the emergence of a greater number of startups. A study on the start-up financing ecosystem, World Bank (2022) shows that in Malaysia, there are two main funding gaps in firms' lifecycle. The first gap occurs in the ideation stage, during which a business develops a minimum viable product, while a second relates to the early-stage series funding in the Series A and B rounds. Traditionally, the government has played a key role in providing support during the ideation stage, due to the high level of risk aversion in the private funding space. However, in recent years, the focus of government grant funding has been shifting away from this phase to concentrate on the commercialization stage of the firm's lifecycle (e.g., Cradle Fund). World Bank (2022) provides concrete recommendations to recalibrate government support programs and incentives to crowd in private investments in this space.

Productivity gaps between SMEs and larger businesses can be attributed both to low levels of technology adoption and diffusion and to weaknesses in firms' capabilities and managerial practices. At the same time, the current business climate increases the urgency for SMEs to digitalize and adopt technologies that improve productivity. Although programs exist to support SMEs in their endeavors to improve managerial practices and quality standards, these programs are usually very small compared to programs that support other activities/ objectives.

RECOMMENDATION 5: Enable productivity improvements in SMEs through support for enhanced managerial practices within SMEs.

It is important to foster a commitment to lifelong learning among both managers and employees and to reinforce efforts to close the skills gaps between Malaysia's SMEs and large companies and SMEs in other countries. The World Bank (2020f) study presents a number of policy recommendations to address gaps in managerial practice. Efforts to close skills gaps could be reinforced through strengthened workforce training programs,

with coordination with the private sector to improve the effectiveness of existing training interventions and to alleviate skill mismatches in industry and the labor market.

Policies and programs that facilitate the diffusion of information and that provide hands-on support for good management practices can be crucial towards improving the quality of these practices. The diffusion of information related to best practices and the provision of support to SME managers to critically evaluate their own practices in a non-threatening way could be particularly cost-effective. In terms of targeting, these interventions should prioritize firms where self-assessment gaps between actual and self-reported management practices are most pronounced, particularly in the case of smaller and younger firms. In addition to the diffusion of information, the provision of hands-on support to implement modern management practices can improve productivity (Bloom et al. 2013). While Malaysia already implements some such support, it could strengthen and scale up these efforts. Existing programs with limited emphasis on improving managerial practices could revise their focus to include such components into their programs.

Additionally, SMEs (especially family-owned firms) have significant potential to leverage external management services and consultancies to adopt international quality standards that could improve their ability to achieve increased growth, greater exports, and closer linkages with suppliers. Interventions could focus on upgrading managerial capacity, with the promotion of these services among family-owned businesses, including through SME associations, regional authorities and intermediaries. The realization of productivity gains through improved management practices will necessitate increases in the intensity of competition, reforms to the ownership structure of firms, and investments to enable access to talent through higher quality education and training.

RECOMMENDATION 6: Establish closer linkages between programs that support upskilling and that provide training with those that support the increased uptake and adoption of technology.

While there are numerous programs that provide financing and advisory, training and support for SMEs, a large proportion of them provide financing for the procurement of fixed assets, such as premises or machineries. This relatively unconstrained funding could reduce the effectiveness of these funds. Funding should have clearly specified targets, with clarity regarding the purpose and means by which these programs are intended to achieve the specified targets. Programs that provide funding to SMEs to increase technological uptake should also include the appropriate support for training or advisory services for these new technologies to ensure the SMEs reap the optimal benefits from the adoption of these new technologies.

SME Innovation Capabilities and R&D

In Malaysia, private-sector R&D is largely driven by foreign-owned or large firms. In recent years, business R&D has taken a hit, with some businesses shifting R&D away from Malaysia. There is limited demand for innovation and R&D amongst SMEs, which makes it more difficult to facilitate the emergence of domestic innovation champions. Furthermore, there is only a limited number of support programs that encourage business R&D. Although there are some general incentives to encourage R&D, few of these are specifically intended to support SMEs. The promotion or introduction of incentives to specifically encourage R&D on the part of SMEs could further support improvements to their R&D capacities.

RECOMMENDATION 7: Innovation support programs to crowd in private investments in early-stage financing.

Incubators and accelerators remain integral to the foundation of the start-up ecosystem, playing a vital role in seeding strong start-up deal close. They also play a key role in the entrepreneurship ecosystem by mentoring and identifying healthy deal-flow pipelines at the ideation stage in a highly risk averse context. As stated earlier, there is an existing funding gap in the ideation and the early-stage series funding for startups in Malaysia. In this context, a re-direction of government funds towards private-sector-managed incubators and accelerators could crowd-in increased private funding in this space (see World Bank (2022) for details).

SME Innovation Linkages

Establishing and expanding the technical know-how and knowledge of SMEs can boost productivity and support economic growth. One of the means by which this could be achieved is through increased collaboration between SMEs and universities and/or MNCs, with these linkages having the potential to create technological spillovers and knowledge transfers. At present, weak collaboration and knowledge linkages constrain the development of regional innovation systems, with a distinct lack of collaboration between SMEs and academic institutions (World Bank 2020a). This is partly due to the lack of SME expertise and know-how and to the limited incentives to encourage technology transfer. With Malaysia attracting new high-value investments into the economy, exploring ways to enable SMEs to increase their capabilities to successfully establish linkages with these MNCs could play a crucially positive role in realizing optimal gains from these increased foreign investments.

RECOMMENDATION 8: Foster linkages between SMEs and innovators (MNCs and academia) to encourage and incentivize innovation by SMEs.

Malaysia's SME development program portfolio also contains only a limited number of programs that facilitate linkages between SMEs and academia. To realize the potential benefits of such linkages, direct and indirect incentives could be increased to encourage collaboration, with measurable targets for both the SMEs and academic institutions to attain through the linkage. So far, collaborative linkages between local SMEs and foreign or large firms have been limited. Customizing existing supplier or industrial linkages programs to facilitate improved SME capabilities would help to increase the potential linkages between SMEs and MNCs. In response to the current crisis, the government has also initiated an online portal platform, MyAssist MSME, which offers business advisory and business matching services. It would be useful to conduct a full evaluation to determine the extent to which programs that are intended to increase SME capabilities through skills upgrading and linkages with large firms (both Government Linked Corporations, or GLCs, and Multi-National Corporations) achieve their intended objectives, so as to provide inputs to improve their design and implementation.

Appendices

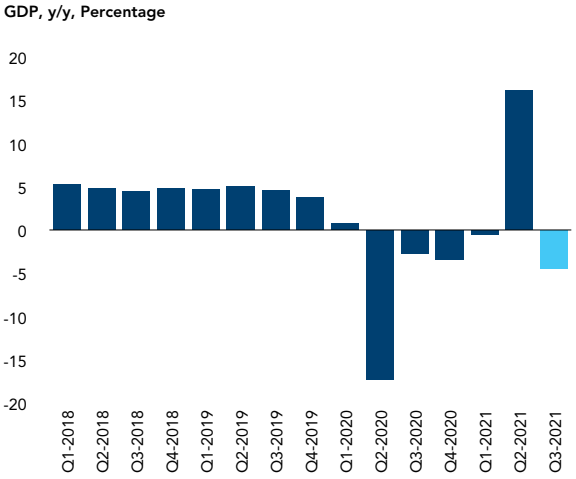
Appendix 1: Recent Macroeconomic Developments in Malaysia

The domestic and global macroeconomic environments play a pivotal role in determining the short-term performance of Malaysia's SMEs and the demand and supply conditions for SME goods and services. Recent macroeconomic developments have created unfavorable conditions for SMEs, despite some positive signs of recovery, albeit at a slow pace. This section draws upon the most recent iterations of the Malaysian Economic Monitor (World Bank 2021b; World Bank 2021c) to highlight some of the key macroeconomic developments in Malaysia that are relevant to the private sector.

Malaysia's economic growth decelerated markedly in Q1 2020, with substantial contraction in Q2 2020, during which the economy contracted by 17.1 percent, from a marginal growth rate of 0.7 percent in the previous quarter. Overall, Malaysia's economic performance in Q2 2020 was the worst since Q4 1998, during the Asian Financial Crisis. In Q2 2020, there were drastic decreases in all components of GDP except for government consumption (see Figure 77), with all sectors except for agriculture recording a decrease in economic activity. In Q3 2020, somewhat improved economic performance was recorded, with a rebound in growth (see Figure 76). Malaysia's economy contracted by 0.5 percent in Q1 2021, moderating from the decline of 3.4 percent in the previous quarter (see Figure 76). While negative spillover effects from the pandemic continued to weigh on the economy in Q1 2021, these effects were cushioned by less restrictive movement control measures. Domestic activity also benefited from the rebound in major economies and the general strengthening in global trade activity. A number of policies outlined in the government's stimulus packages also provided crucial support to the economy during the quarter.

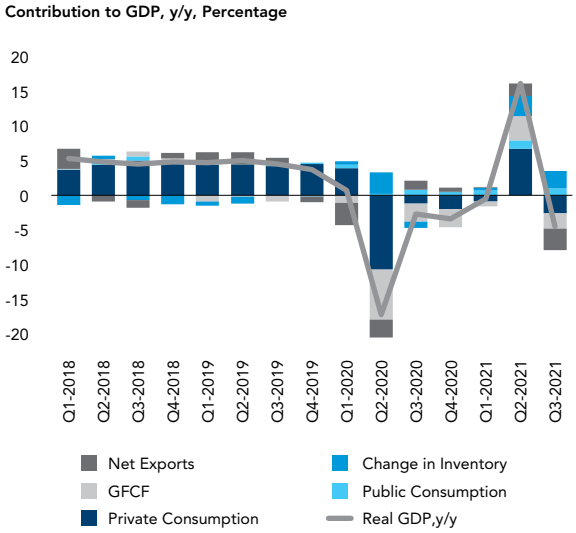
However, the re-imposition of stringent movement controls severely impacted the domestic economy again. Malaysia's economic growth contracted by 4.5 percent in Q3 2021 after a strong 16.1 percent expansion in Q2 (see Figure 76). Private consumption contracted by 4.2 percent (Q2 2021: 11.7 percent), as COVID-related

Figure 76: Malaysia's Quarterly GDP Growth



Source: DOSM

Figure 77: Malaysia's GDP Growth Composition



Source: World Bank staff calculations based on DOSM data

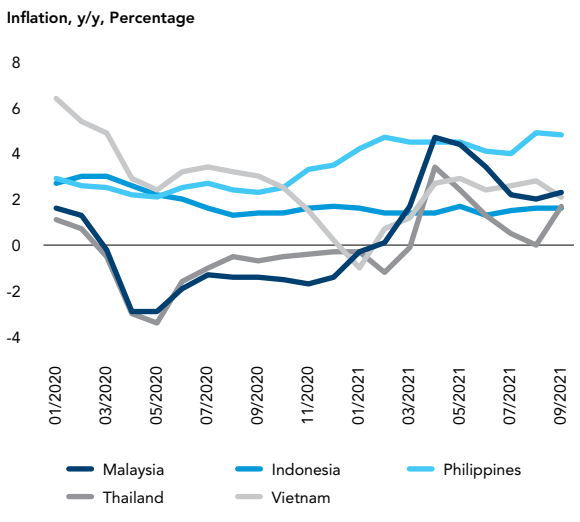
restrictions, heightened cautionary behavior among consumers, and elevated concerns over employment and earnings constrained spending by households. Investment activities were also affected as business sentiments deteriorated. Economic activity was supported mainly by government spending on COVID-19 related goods and services (see Figure 77).

Towards the end of 2020, Malaysia's export performance improved, largely due to the increase in electronics and electrical (E&E) manufacturing (World Bank 2021b). In Q1 2021, Malaysia's exports accelerated, largely due to the strengthening of global economic activity. Gross exports expanded for the third consecutive quarter, at the rate of 18.2 percent at the end of Q1 2021. Additionally, this trend remained and much of the recent export growth momentum was driven by manufacturing exports of other goods.

Relative to other regional countries, inflationary pressures in Malaysia remained contained relative to other regional countries. Headline inflation stood at 2.2 percent during Q3 2021, compared to 4.1 percent in Q2 2021. The more benign inflation trend in Malaysia was driven by several factors. First, it was contributed by a smaller base effect from fuel prices in the same period in the previous year. Second, the government implemented an electricity bill discount which led to lower utility prices (see Figure 79). Third, domestic prices of essential commodities, such as rice, sugar, and fuel, are either administered or subsidized by the government. This slowed down the propagation of higher global commodity prices to domestic inflation.

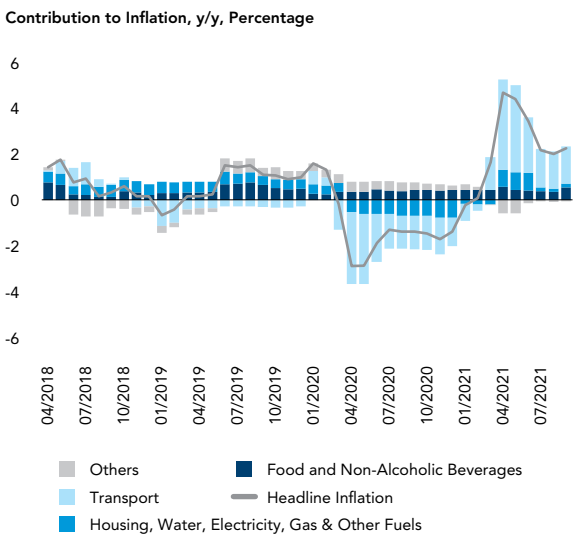
Nevertheless, recently there has been a marked surge in the prices of selected food items. The government has indicated that the sharp increase in food items such as poultry and vegetables was driven by a shortage in supply, as adverse weather conditions and shortage of foreign labor have affected the production of fresh produce. Nevertheless, the government is looking into measures to manage the price increases and plans to set-up temporary markets which will offer basic necessities at prices up to 20 percent lower than market prices. Underlying inflation, as measured by core inflation, has been broadly stable at 0.6 – 0.8 percent throughout the year in the absence of immediate domestic cost pressures.

Figure 78: Inflation Rates for Malaysia and Regional Countries



Source: World Bank staff calculations based on DOSM data

Figure 79: Inflation Composition

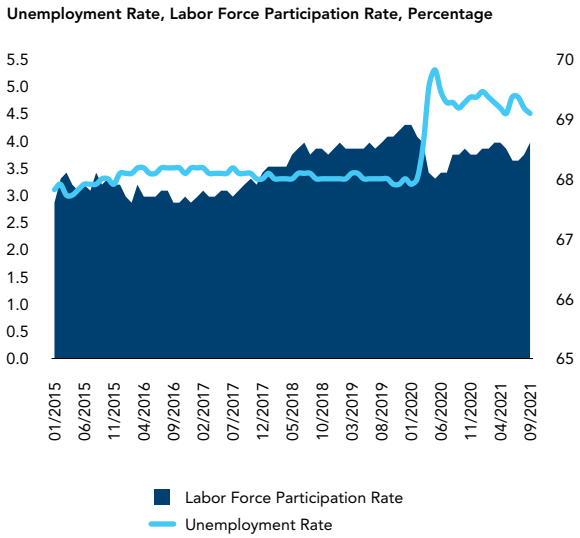


Source: World Bank staff calculations based on DOSM data

Despite initial signs of a gradual recovery in the labor market, Malaysia's unemployment rate remained elevated. In the first quarter of 2021, there were some small indications of gradual improvements in the labor market. These improvements were characterized by a lower rate of contraction in employment growth (Q1 2021: -0.05 percent; Q4 2020: -0.6 percent) and a greater increase in the labor force participation (1.4 percent; Q4 2020: 1 percent). The re-imposition of movement controls also interrupted the nascent recovery of the labor market. Despite early signs of recovery, the unemployment rate remained elevated, at 4.8 percent during Q1 2021 and remained around similar level up to Q3 2021 (see Figure 80).

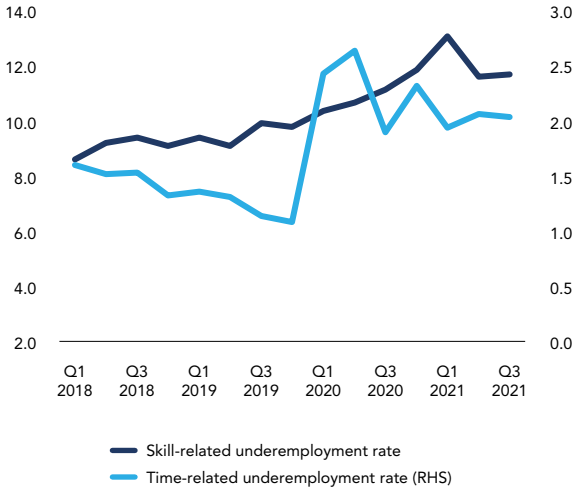
The implementation of movement restrictions since Q1 2020 has contributed to relatively high underemployment rates. In terms of skills-related underemployment indicators, which capture the number of people with tertiary qualifications who work in semi-skilled or low-skilled jobs, the rates remained high in Q3 2021 (see Figure 81). Skill-related underemployment has risen over consecutive quarters since the onset of the COVID19 pandemic in Q1 2020 and stood at 13.1 percent at the end of Q1 2021 and marginally improving to 11 percent at the end of Q3 2021. Meanwhile, in terms of time-related underemployment, which captures those who are employed for less than 30 hours per week due to the nature of their work or to the insufficient availability of work, the rate slightly declined to 1.9 percent in Q1 2021 and maintained at similar levels at the end of Q3 2021 (down from 2.3 percent in Q4 2020). If left unaddressed, these trends could lead to higher levels of underemployment and unemployment relative to the pre-crisis period. Further, a large share of Malaysians on low incomes are employed in sectors that make working from home very difficult.

Figure 80: Malaysia's Unemployment Rates



Source: World Bank staff calculations based on DOSM data

Figure 81: Malaysia's Underemployment Rates



Source: World Bank staff calculations based on DOSM data

Appendix 2: The Enterprise Survey and the COVID-19 Business Pulse Survey

World Bank Enterprise Surveys

The World Bank Enterprise Surveys is a survey program conducted to enable international benchmarking and the analysis of business environment constraints. Over 168,000 firms in 144 countries have been surveyed according to a global methodology. The standard Enterprise Survey topics include firm characteristics, gender participation, access to finance, annual sales, costs of inputs/labor, workforce composition, bribery, licensing, infrastructure, trade, crime, competition, capacity utilization, land and permits, taxation, informality, business-government relations, innovation and technology, and performance measures. Over 90 percent of the questions are intended to objectively ascertain be characteristics of a country's business environment. The remaining questions assess the survey respondents' opinions regarding the obstacles facing firm growth and performance. The surveys use face-to-face interviews as the principal mode of data collection.

The Enterprise Surveys utilize a stratified random sampling methodology. In a simple random sample, all members of the population have the same probability of being selected and no weighting of the observations is necessary. This method allows computing estimates for each of the strata with a specified level of precision, while population estimates can also be estimated by properly weighting individual observations. The sampling weights address the varying probabilities of selection across different strata. Under certain conditions, the precision of the estimates under stratified random sampling will be higher than under simple random sampling (lower standard errors may result from the estimation procedure).

The strata for Enterprise Surveys are firm size, business sector, and geographic region within a country. Firm size levels are based on the number of employees, as follows: 5-19 (small), 20-99 (medium), and 100+ employees (large-sized firms). Since in most economies, most firms are small and medium-sized, Enterprise Surveys oversample large firms, since it is acknowledged that larger firms tend to be engines of job creation. Firms are usually broken down by sector, as follows: manufacturing, retail, and other services. For larger economies, specific manufacturing sub-sectors are selected as additional strata, based on employment, value-added, and total number of establishments figures. Geographic regions within a country are selected based on which cities/regions collectively include the greatest volume of economic activity. For this study, the most recently available data for Malaysia and comparator countries are used. It should be noted that the classifications of business sizes or sectors in this study may not exactly match the classification of the World Bank Enterprise Survey.

COVID-19 Business Pulse Survey for Malaysia

The COVID-19 Business Pulse Survey (BPS) is a rapid survey designed to measure the various channels of the impact of COVID-19 on firms, firm adjustment strategies, and public policy responses. The World Bank, in collaboration with a private survey company, conducted the first round of the Malaysia BPS in October 2020. In total, 1500 firms were sampled randomly from an online business panel database, which includes more than 100,000 companies in all sectors and sizes across Peninsular and East Malaysia. A minimum sample size was obtained for sectors that are important to Malaysia's economy and that are considered to be particularly sensitive to the COVID-19 crisis (export-oriented activities: electronics, automotive, tourism related activities) while preserving the sectoral shares in the sampling frame. Due to lack of statistics regarding the true universe of firms, all analyses were conducted without weights.

Appendix 3: Roadmap of Malaysia's SME Development Policies

With the Malaysian economy experiencing a sectoral shift from agriculture and mining to manufacturing over recent decades, SMEs in Malaysia have followed the same sectoral shift. After Independence and up to the 1970s, SMEs in Malaysia were largely involved in the agricultural industry and the provision of small-scale services, such as wholesale and retail trade. After that point, there was a growing diversification from mining and agriculture towards manufacturing activities within the overall economy. In particular, Malaysia's manufacturing sector drove growth in Malaysian exports, especially electrical and electronic products. The sectoral shift inevitably led to the establishment of many SMEs in the manufacturing sector as well.

During this period, Malaysian Government focused more on facilitating the development of a higher value-added manufacturing sector through upstream and downstream activities. During the expansion of the manufacturing sector, SME development strategies mostly emphasized the development of domestic small-scale, market-oriented industries, with a focus on establishing the Bumiputera commercial and industrial community (NSDC 2005). Greater emphasis on SME development was evident from the 1990s, particularly with the promulgation of the Second Industrial Masterplan 1996-2005 (IMP2), which was followed by a subsequent industrial plan and the SME Masterplan (2012-2020). The IMP2 was intended to address a number of issues faced by Malaysian enterprises including market access, technological capabilities, and ICT adoption, and access to finance (MITI 1996). It was built upon the previous industrial policies and placed a larger emphasis on upgrading products and value chains within the manufacturing sector. It aimed to promote cluster-based industrial development strategies, in which SMEs could build upon and leverage their relationships with multinational enterprises (MNEs) to enhance their own capabilities and productivity.

Government policies and economic development strategies have evolved to reflect changes in the domestic and global economy, which have also shaped the development of SMEs. The period of the IMP2 coincided with the Asian Financial Crisis in 1997-1998, during which period the role of SMEs in the Malaysian economy became more important. The crisis resulted in a withdrawal of foreign investors from Malaysia, leading to a drastic reduction in foreign direct investments (FDIs). This motivated a change in strategy intended to ensure Malaysia did not become excessively reliant on FDI to stimulate its economy. Thus, SMEs in Malaysia were targeted as the key to generate domestic-led investments; to maintain are and stimulate the labor market; and to stimulate economic expansion. Thus, the Seventh Malaysia Plan (1996 – 2000) adopted a new strategy of promoting SMEs that exhibited strong growth potential and enhancing the capacities of SMEs to become export-oriented and globally competitive.

Since the 1990s, Malaysia's focus on SME development policies and strategies has continued to grow. To develop resilient SMEs in sectors with high growth and export potential, the government implemented a number of key measures to ensure strong support. The formation of the Small & Medium Industries Development Corporation (SMIDEC) under the Ministry of International Trade and Industry (MITI) in 1996 was intended to drive continuous development. SMIDEC's role in the SME ecosystem was to provide infrastructure support, financial assistance, advisory services, market access, and other support programs for Malaysian SMEs. This role continued throughout the period of the 8th Malaysia Plan (2000 – 2005), with the government providing substantial support for the development of SMEs, with considerable attention given to the provision of infrastructure and amenities such as SME industrial parks and business incubation facilities to support the expansion of SMEs across Malaysia (EPU 2001). Additionally, an important milestone for SME development in Malaysia was the establishment of the National SME Development Council (NSDC). The NSDC played a

number of roles, including formulating strategies and coordinating policies and programs implemented by related ministries and agencies. However, the main role of the NSDC was to ensure that SME development plans were focused on the achievement of higher-level objectives. Chaired by the Malaysian Prime Minister, the government's establishment of the NSDC was a clear statement of its commitment towards the development of the country's SMEs.

The government remained committed to the implementation of strategies for the development of SMEs over the next decade, albeit with a number of changes in priorities. During the period of the Ninth Malaysia Plan (2006 – 2010) and the Third Industrial Masterplan 2006 - 2015 (IMP3), the government aimed to transform Malaysian SMEs into knowledge intensive entities and to provide higher value-added to address mounting pressures and increased challenges related to the evolving global environment. Some of the strategies introduced by the government included measures to upscale the manufacturing sector to encourage greater engagement with higher value-added activities, to build capacities in related sectors, and to enhance overall productivity. Additionally, greater emphasis was placed on improving the development capabilities of SMEs to acquire and adopt new technologies and to create a greater number of local technology-based companies to achieve greater product and service differentiation. The government also aimed to nurture the technological capabilities of Malaysian SMEs and to encourage SMEs to engage in R&D or to engage in partnerships with large multinational corporations or government-linked companies (GLCs) to facilitate such R&D. Collaborative projects and research between multiple entities was widely encouraged, including enterprises (SMEs and otherwise), universities and research institutions, and government agencies in order to increase knowledge and technology transfers and to increase technology extension towards SMEs. In 2007, the government announced the official handover of the NSDC to SMIDEC, as the dedicated agency tasked with the formulation of overall development policies and strategies for SMEs and to serve as the coordinating agency for SME development programs across all related ministries and agencies. SMIDEC was then rebranded as the SME Central Coordinating Agency, or SME Corp.

Based on a recognition of the significance of SMEs to the Malaysian economy, the government planned new initiatives to leverage the potential of SMEs to increase productivity and to promote inclusive growth. The New Economic Model (NEM) launched in 2010 recognized the need to further support the growth and to increase the competitiveness of SMEs as a crucial component of Malaysia's strategy to become a high-income nation. The government developed new mechanisms to provide financial and technical support to SMEs in innovative and technologically advanced areas to support their growth and competitiveness in the context of the liberalization and deregulation of the Malaysian economy (Chin and Lim 2018). Special attention was given to SMEs with innovative potential to support their transformation. This all culminated in the promulgation of a masterplan for SMEs to ensure growth consistent with the goals of the NEM.

The launch of the SME Masterplan 2012-2020 sparked a major shift in the trajectory of government support for Malaysian SMEs. Spearheaded by SME Corp, the government developed a long-term growth strategy, the SME Masterplan 2012–2020, to foster overall SME development, with a focus on six high-impact programs (HIPs) and 26 policy measures (see Table 6). The SME Masterplan envisioned increasing the participation of SMEs in the national economy, setting ambitious targets to be attained by 2020, which included increasing the contribution of SMEs to national GDP to 41 percent; employment to 65 percent; and exports to 23 percent. To achieve these objectives, the government developed four key strategic goals:

a) Increasing the rate of business formation;
b) Expanding the number of high growth and innovative SMEs;
c) Raising the productivity of SMEs; and
d) Intensifying the rate of formalization

The SME Masterplan aimed to enable SMEs to grow beyond the domestic market and to encourage innovations within SMEs. Apart from the HIPs, fifteen government ministries and more than 60 agencies were involved in supporting the development of SMEs through a large number of other programs. A large proportion of the resources were provided to programs related to financing, while the largest number of programs were related to capacity building (Chin and Lim 2018). While the efficacy of the implementation of the HIPs and of the supporting initiatives were largely mixed but nonetheless, the implementation of the SME Masterplan resulted in the generation of a large number of lessons learnt, providing a basis for further refinement and revision.[50]

Table 6: List of High Impact Programs Associated with the SME Masterplan 2012-2020

HIP	Implementing Agency	Description
1	Malaysian Administrative Modernization and Management Planning Unit (MAMPU)	**Integration of registration and licensing of business establishments** to create a single registration point by interfacing the current National Business Registration System (MyCOID) and the National Business Licensing System (BLESS).
2	Malaysia Innovation Agency (through PlaTCom Ventures)	**Technology Commercialization Platform (TCP)** to remove market barriers to innovation by providing handholding to SMEs that have innovative ideas to proceed from proof of concept (POC) to the commercialization stage.
3	SME Corporation Malaysia (SME Corp)	**SME Investment Program (SIP)** to provide early-stage financing through the development of investment companies that would invest in potential SMEs in the form of debt, equity, or a hybrid of both.
4	Malaysia External Trade Development Corporation (MATRADE)	**Going Export (GoEx) Program** offers customized assistance to new SME exporters or those venturing into new products or markets to overcome the information barriers and to help link them to the final buyers.
5	SME Corp	**Catalyst Program** aims to create home-grown champions through a targeted approach, building up the capacity of the firms through support on certification, market access, entrepreneurial and human capital development, and access to financing.
6	Yayasan Inovasi Malaysia	**Inclusive Innovation** to empower the bottom 40% of the income group to leverage innovation to promote the transformation of communities including microenterprise in the rural and urban areas.

Much of the focus of Tenth Malaysia Plan (2011 – 2015) in so far as it relates to SMEs was in line with the goals and targets outlined in the SME Masterplan, with the main focus being to enable Malaysia's SMEs to become domestic, regional, and global champions. The government implemented initiatives to improve the regulatory conditions, to increase access to financing, to enhance entrepreneurship, and to build capacities. The development programs implemented under the Tenth Malaysia Plan focused on five main areas: a) human capital development; b) market access; c) access to finance; d) innovation; and e) infrastructure. The SME Masterplan provided a much more detailed analysis of SMEs, with impact assessments of available programs, the development of new SME frameworks, the identification of SME performance driving forces, and proposed action plans. The identified SME performance driving forces were: a) innovation and technology adoption; b) human capital development; c) access to financing; d) market access; e) legal and regulatory environment and f) infrastructure. These driving forces form the basis of the currently available SME development programs.

50 For a more comprehensive study on The SME Masterplan, please refer to The World Bank's "Malaysia's Experience with the Small and Medium Sized Enterprises Masterplan: Lessons Learned" (World Bank 2020e).

Appendix 4: Analytical Framework and Methodology

Chapter One focuses on providing an overview of SMEs in Malaysia and some of the underlying trends pertinent to Malaysian SMEs. Malaysia is benchmarked against relevant regional comparators and global comparators at comparable and aspirational income levels. The study relies on a multitude of data and statistics from the national accounts, and on aggregated data from a multitude of databases for benchmarking against different countries. Additionally, the analysis draws upon previous studies conducted by the World Bank and a systematic review of relevant research papers and reports.

In the second chapter, the assessment of the SME policy mix relies primarily on data provided by SME Corp through the SME Integrated Plan of Action (SMEIPA). Each program was further investigated by collecting information from documents available online. When further information was required, the relevant program implementers were contacted. More than 270 SME programs were identified and mapped to specific criteria covering the objective of instruments, the mechanisms involved, beneficiary focus and other factors. This analytical component builds the profile of the policy mix. At the core, the exercise is intended to assist practitioners to populate the matrix for policy mapping.

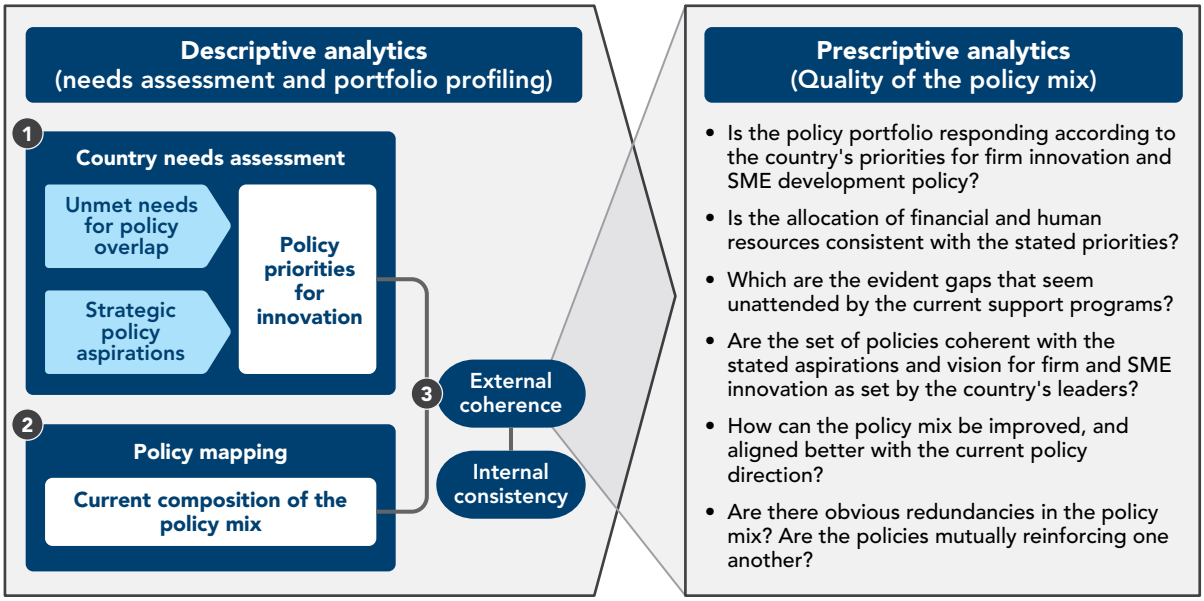
The main goals of this tool are:

- The collection of the data to map the portfolio of programs.
- The establishment of a basis to run descriptive analytics and to profile the portfolio.

The expected results from the data collection exercise include a database of the portfolio according to the specified parameters of interest, and a descriptive profile of the instrument portfolio and policy mix. More broadly, the policy map will provide a representation of the SME and entrepreneurship budget structure and its allocation by intermediate outcomes. With this profile, the team will be able to assess the internal consistency of instruments in terms of resource allocation by assessing factors related to size, scale effects and redundancies, and the alignment between policy objectives/outcomes, departments' mandate, instruments used and types of beneficiaries, to evaluate the coherence between the demand for SME support and the composition of the portfolio of instruments or policy mix.

In addition, the country needs assessment, and the data collection exercise and analyses can help to provide an answer to some of the key questions that the study seeks to address, as shown below:

Figure 82: General Analytical Framework Used for Policy Mix Assessment



Source: World Bank staff illustration

Table 7: Category Description of Profiling Parameters

Category	Definition	Objective	Variables[51]
1. General Information	Instrument identification and dependency.	Identify budget allocation, agencies/departments' roles, overlaps, budget concentration, and capacities concentration.	• ID, ministry/institution, directorate, department, agency, etc.
2. Economy/ society outcomes	Impact and effects aiming to obtain with the instrument. Expected results to generate in the economy as well as in society.	Capture high-level outcomes related to policy aspirations. The capture of these can inform coherence analysis between instrument goals and systemic.	• Productivity, diversification, research excellence, societal development, technology adoption, new markets, human capital, social innovation, start-up behavior, etc.
3. Instrument objective	Relates to the state or goals the instrument intends to produce	Register the intent behind the policy program, to address specific market failures or identified problems.	• Research excellence, technology transfer, science industry collaboration, business R&D, non-R&D innovation, technology adoption, etc.
4. Mechanism of Intervention	Type of instruments or actions used to deliver and implement the program.	Categorized the tools and mechanisms used to deliver the pool of programs to analyze their suitability to the needs.	• Grants, vouchers for innovation and collaboration, tax incentives, early-stage infrastructure, scholarship, advisory, credit, etc.
5. Grant Usage	Purpose and destination of the resources under the grant category.	Assessment of the portfolio of instrument mix and value the different lines of support.	• Market research, space and rent, business operation, promotion and marketing, etc.

51 The metrics would often be dummy variable, 0 or 1, to indicate the presence or absence of each variable. Percentages may be used when it can denote the level of action or presence in a variable. In addition, overlaps and redundancies can be register as well.

6. Geographic coverage	Relates to the scope of application of the instrument, and where do the intended beneficiaries lie on the map.	Understand the breadth of application of the instrument	• National, regional and provincial instruments.
7. Sector	The sector where the instrument is targeted	Separate by sector the level of support and instruments available	• Agriculture, manufacturing, mining, tourism, forestry, construction, fishing, technology, education, health service, finance, retail, transportation, entertainment, etc.
8. Beneficiaries	Group of people or institutions which the program is targeting	Map the different groups who are receiving any type of funding or support	• Private Sector, Non-Governmental Organization, Universities, Start-ups, etc.
9. Life Cycle	Which phase of the business is being targeted for support (applies for business ventures)	Map the various supports along the different stages of the business	• Seed and pre-seed, young start-ups, scale-up, mature.
10. Size	Range of revenue generated by the companies supported	Measure the proportion of support for each group	• Micro, Small, Medium, Large
11. Innovation propensity of the beneficiary	Which innovation stage is being supported	Acknowledge the level of engagement and support	• Non-innovator, potential innovator, innovator.
12. Budget	Revision of different years, ideally last 3 years (disperse)	Compare and recognize trends, changes of strategies and commitment through time	• Years analysis
13. Budget Source	Where does the money come from, account name or department glossary	Identify the different levels of support and funding inputs	• Source of funding

Description of Variables Mapped

From the data provided and from additional research into the SME programs, new variables were created following specific criteria and descriptions. The classifications used in this study are listed below.

Table 8: Description of Categories and Variables of Economic or Social Outcomes

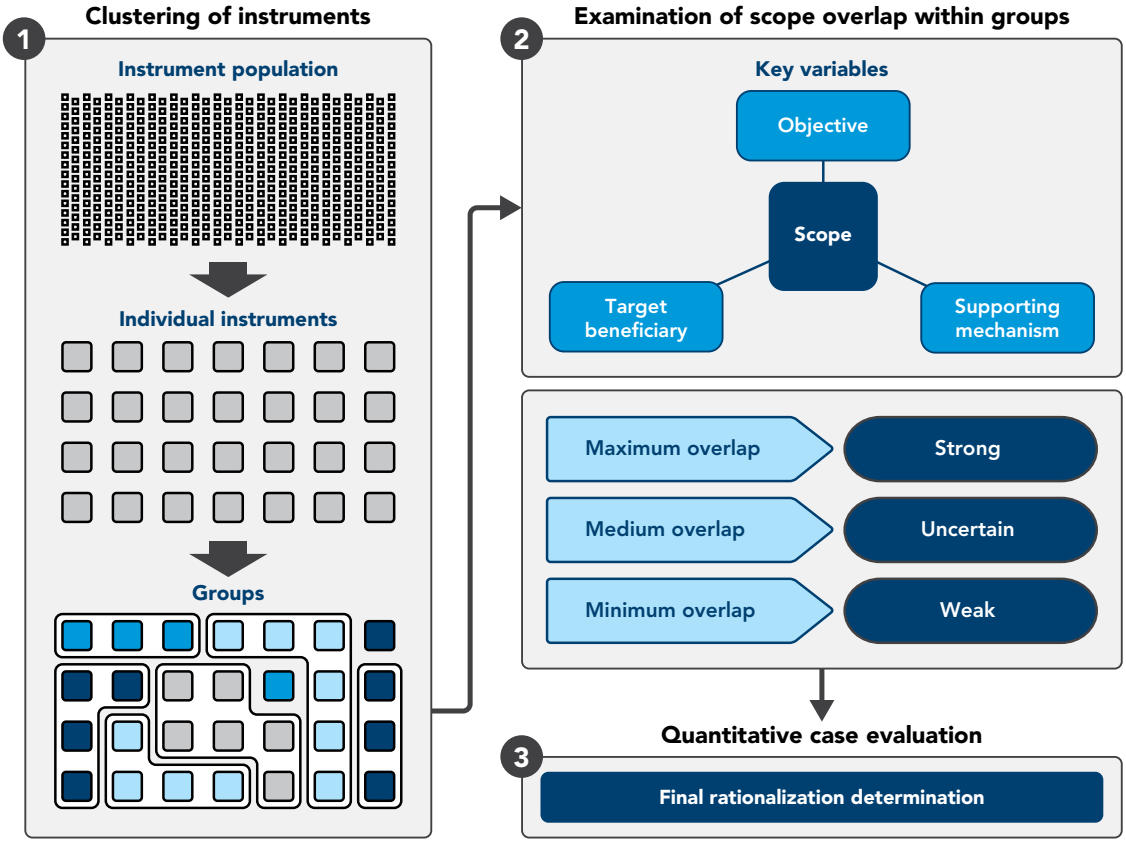
Productivity growth, firms upgrading in existing business, technology adoption and diffusion	General objective of instruments that aims to improve productivity and performance of existing business. Usually instrument targeting innovation, exportation or overall growth of firms.
Diversification, new ventures, new markets	Explicit new business diversification goal - startups, new businesses, new sectors or new markets.
Knowledge creation	Only instruments aimed at improving knowledge and excellence in research. Does not include company R&D.
Human capital, skills and jobs	Instruments that aim to improve the level of human capital. This includes tools for training, capacity building and improving management practices - STEM skills, technical skills or engineering capacity enhancement tools.
Societal inclusion	Instruments that have as their direct objective the improvement of social inclusion. Example, working only with beneficiaries from disadvantaged groups or innovating solutions to serve these specific groups.
Environment, climate change	Only instruments that have environmental improvements as their direct objective - renewable energy, energy efficiency.

Table 9: Description of Intermediate Objectives

Research excellence	Instruments with the direct objective of facilitating knowledge transfer from universities, research centers and other knowledge providers to the private sector. Examples are university business collaboration projects, technology transfer units, and patent support instruments.
Technology transfer and science-industry collaboration	Instruments to support technology transfer and industrial science collaboration between research or technology entities and industries.
Business R&D and R&D-based innovation	Instruments that seek to encourage direct R&D in already established companies.
Non-R&D innovation, **technology adoption** or diffusion	Instruments seeking support for the adoption of new technologies innovation equipment, product innovation projects, business model process that do not need formal R&D.
Management practices	Instruments whose direct objective is to improve the quality of corporate management practices.
Access to finance	Instruments whose direct objective is to improve access to finance and to improve the financial market.
Export promotion	Instruments with the direct objective of increasing exports. Examples are export credits, drawbacks or export quality improvement.
Skills formation	Instruments with the direct objective of training workers for better insertion in the private sector and capacity building in areas with disabilities.
Entrepreneurship	Instruments aimed at improving the quality and quantity of entrepreneurship - training in elements of entrepreneurship culture, non-management practices, entry of new businesses.
Improving business climate or regulatory environment	Instruments with the direct objective of improving the business climate. It must have specific activities oriented towards this goal such as normative, deregulation or process simplification.
Domestic market access	Instruments that aim to enter new domestic and international markets. Instruments for exploring new markets or connecting markets through improved information, logistics, connectivity.

Appendix 5: Cluster Analysis

To investigate potential redundancies, a cluster analysis was conducted to identify underlying structures in the programs. Objectives, supporting mechanisms and target beneficiaries were the variables selected for running the clustering, considering their prominent role in defining the scope of the instrument, methods of intervention, and their relationship with certain market failures and solutions to address these issues. The figure below describes the methodology for identifying potential redundancies:



Source: World Bank staff illustration

The framework defines three proxy variables to lay out the scope of the program overlap which are objectives, beneficiaries and supporting mechanisms.

i. **The analysis relied on cluster analysis to create measures of similarity between pairs of objects, using these variables.** The cluster analysis assigns instruments into groups (by similarity of scope). We used this segmentation to look closer at each group of instruments to identify potential cases that present overlapping scope.

ii. **As a result, the findings recommend additional examination of these cases depending on the degree of overlap** (strong: overlap of 3 variables; uncertain or moderate: overlap of 2 variables; and not applicable: overlap of 1 var or less) to explore potential integration or consolidation of programs.

iii. **Further qualitative scrutiny will validate some of the assumptions based on context and detect any nuanced issues.**

The analysis relied on forming clusters from objects, starting with an individual cluster. We then merged clusters sequentially, according to their similarity. The algorithm creates various measures to express (dis)similarity between pairs of objects, using the segmentation variable. Cluster analysis of the instruments divided the sample into six main groups, in terms of similarities of general objectives in economic outcomes, specific objectives, beneficiaries, and supporting mechanisms. We used this segmentation to look closer at cases that presented overlapping scope, which suggests additional examination can be applied to explore potential integration or consolidation of programs. In particular, a cluster analysis using Ward's method with the Jaccard distance measure was conducted.

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