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Internationalization of Small and Medium Enterprise in Malaysia: Financial Problem as a Key Factor

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Abstract: Economic growth is depend to internationalization and innovation. While arguing that SMEs are assumed as the backbone of industrial development and they andplay an important role in internationalization and they are interested in rapid growth, they are limited by financial resources. In a knowledge-driven economy such as Malaysia, economic growth is increasingly dependent upon innovation and internationalization, SMEs have financial problems. This study shows that availability and accessibility to the finance is one of the most challenges for SMEs.

Key words: SMEs, internationalization, accessibility, availability, finance, Malaysia

INTRODUCTION

SMEs are assumed as the backbone of industrial development globally and have a key role in economic development in both developed and developing countries (Alam and Noor, 2009) like Malaysia (Saleh and Ndubisi, 2006; Radam *et al*., 2008; Khan and Khalique, 2014). SMEs include >95% of all companies in different countries and in both developed and developing countries, specifically developing countries SMEs have potential to enhance income distribution, reinforce industrial relationships to reduce poverty, export growth and employment creation (Pandya, 2012; Hashim, 2000; Lerner, 2002).

In addition, SMEs are the most important drivers of growth in export in countries (Hashim, 2000). Both remarkable increase in exports and contribution in global markets demonstrate the internationalization process. The performance and growth of SMEs are both driven by how they can manage internationalization (Hagen *et al*., 2014; Rask, 2014). Malaysia is known as the 17th largest exporting nation in the world by which almost 80% of overall country's export derived from manufacturing and services sectors with qualified products accepted in developed countries such as US, EU and Japan. The interest in Malaysian SMEs has witnessed a significant growth over the years (SMIDEC, 2002, 2009). The number of SMEs in Malaysia is growing with stronger tendency towards exporting activities than large firms and they are looking for broader market for their products (Senik *et al*., 2010). While arguing that SMEs play an important role in internationalization and they are interested in rapid growth, they are limited by financial resources that (Rosa *et al*., 2003) point out the challenges of access to finance, ability to cope with government regulations and non-availability of adequate professional management expertise as a few of the challenges bedevilling SMEs all over the world. Also in Malaysia the SMEs have a financial problem that financial institutions kept their high growth in financing of SME in 2013.

If there is no suitable financing, SMEs are not able to improve to compete globally and inter to international markets, thus SMEs cannot acquire advanced new technologies or fulfill their working and fixed capital requirements (Wanjohi and Mugure, 2008). In a knowledge-driven economy such as Malaysia, economic growth is increasingly dependent upon innovation and internationalization whereby access to finance is seen as a major challenge that may impede this process (Bygrave and Timmons, 1992; Wonglimpiyarat, 2011).

MATERIALS AND METHODS

Small and Medium Enterprise in Malaysia (SMEs): In Malaysia, the applied criterion used to describe SME has been contributed by prominent researchers and government agencies in SMEs area across Malaysia. Both Small and Medium Enterprise Corporation Malaysia (SME Corp.) consider two main criteria that define the standard definition for Malaysian SMEs which is the total number of employees or annual sales turnover SME Corp. Malaysia in 2011. Considering that there have been many developments in economy since 2005, for example structural changes, price inflation and business trends changes, a definition review has been undertaken in 2013

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Table 1: Number of full-time employess

Variables	Manufacturing	Services and other sector
Micro	<5 full-time employees	<5 full-time employees
Small	Full-time employees from 5 to <75	Full-time employees from 5 to <30
Medium	Full-time employees from 75 to not exceeding 200	Full-time employees from 30 to not exceeding 75

Table 2: Annual sales turnover

Variables	Manufacturing	Services and other sector
Micro	Less than RM 300,000	Less than RM 300.000
Small	From RM 300,000 to less than RM 15 million	From RM 300,000 to less than RM 3 million
Medium	From RM 15 million to not exceeding RM 50 million	From RM 3 million to not exceeding RM 20 million

and a new definition of SME was provided in 14th NSDC Meeting in July 2013. In 2013, 11th July, Prime Minister of Malaysia Datuk Seri Najib Tun Razak announced a new criteria for the SMEs that will be effective on 2014, 1st of January. The tables demonstrate the SMEs classification in Malaysia (Table 1 and 2).

Internationalization of small and medium enterprise: The term 'internationalization' was first introduced in 1920's. Earlier studies on internationalization of market economies tended to cover large business organizations only, neglecting issues related to the less powerful or influential smaller business entities, better known as 'Small Medium Enterprise's (SMEs). However, the researchers are so interested to to the internationalization because of the contribution of the SMEs to economic growth of the country and after that they try to find more about the internationalization growth.

The meaning of internationalization: There are many differences in determining the "internationalization" concept (Coviello and McAuley, 1999; Welch and Luostarinen, 1988; Andersen, 1997; Beamish, 1990; Calof and Beamish, 1995). Different internationalization definitions have been employed by scholars and they vary according to nature and interest of the research. It was identified as the adaptation process of the organizational operations (resource, structure and strategy) to the international context (Calof and Beamish, 1995). Also, other developed definitions define internationalization as a gradual procedure in which a company establishes a network of trade relationships globally whospecifically analyzed the internationalization literature as serted that it is a process by which a company shifts from operating in local market toward global markets.

Export: Regarding internationalization, a global definition of the concept is still elusive (Coviello and McAuley, 1999). However, Beamish (1990) suggests a holistic insight as: "a process through which companies can increase their knowledge of direct and indirect impacts of global transactions in the future and to set up and perform transactions with other nations." This definition shows that exporters only are considered as one factor of the inward/outward global activities.

Internationalization has been broadly employed to define the outward movement of global operations of a company (Zeng *et al*., 2008, 2009). Most of the internationalization researches emphasized outward processes which are relevant to licensing, exporting and foreign direct investment and franchising and exports are the key mode of SMEs internationalization (Eusebio *et al*., 2007; Westhead, 2008; Hyari *et al*., 2012). This research is conducted to analyze only one of the highly relevant features of internationalization which is exporting and it is the most related concept to global business activities of SMEs.

According to Chelliah *et al*. (2010), some important evaluations on relationship between attitudes into exporting and company size have been examined. The findings revealed that SMEs have greater tendency to export compared to large sized companies. Also, SMEs are realized to be actively exploring the market potential in global context and such firms are searching for wider markets for their goods and services. Clearly, all of the firms in this investigation believe that export is a favorable activity and can significantly help with organizational growth and profitability.

Export is a significant strategy of internationalization for both national economies and companies in international markets (Koksal, 2006, 2008). Improving liberalization, competition and integration in global economies have been responsible for rising participation of companies in exports (Ural, 2009). Moreover, globalization across marketplace in general and industrial context has improved both exports and competition. Exporting activities also improve the profitability and trade balances and contribute to coping with unemployment and poverty issues (Karadeniz and Gocer, 2007; Koksal, 2006, 2008; USITC, 2010; Hyari *et al*., 2012).

SMEs internationalization: One of the primary issues of business context in 21th century is the growth of internationalization (Pinho and Martins, 2010; Hyari *et al*., 2012). Study of internationalization of small entities has grown rapidly during the past 20 years. There is a broad and well-developed literature which examined the international growth of small firms (Etemad, 2004; Kuada, 2006; Abdullah and Zain, 2011; Hyari *et al*., 2012).

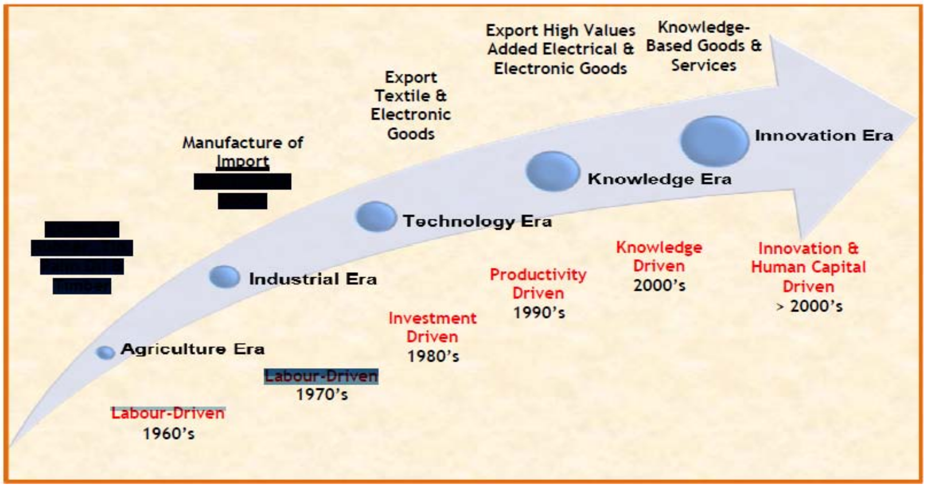

Fig. 1: Malaysian economy transformation

Among those elements which encourage SMEs to penetrate global markets we can name additional profit, market expansion and being exposed to new ideas (OECD, 2009; Abdullah and Zain, 2011). Internationalization can be considered a strategy which makes the firm capable of exploiting new profitable markets outside the local marketplace (Kylaheiko *et al*., 2011). Being successful in local market might limit the ability of SMEs to follow internationalization. As a company obtains success domestically they will concentrate more on cultivating local networks rather than considering the potential international markets (Arbaugh *et al*., 2008; Chelliah *et al*., 2010). On the other hand being successful in local market could be a major push element for organizational internationalization (Cavusgil *et al*., 2008). For instance, SMEs in Europe has revealed their interest in international markets after developing their status in local market (Svetlicic *et al*., 2007).

Those SMEs which participate in international market can benefit from both domestic and global platforms. Within the international market, SMEs which are operating in markets abroad can achieve new experiences and then incorporate them in their domestic operations, thereby pushing them to reinforce their international presence and competitiveness (Hashim, 2000). Internationalization locally provides social prosperity, contributes to increase productivity of national industries, supports socio-economic development, engenders foreign exchange, minimizes the national deficit and improves opportunities of employment. In addition, global expansion has become a primary approach through which SMEs will be able to grow as penetrating new and big markets enables them to improve their customer base, provide large volumes and improve their growth and profits. All of these variables have encouraged SMEs to internationalize and move to new locations geographically.

In emerging and developing countries, internationalization has been assumed as one of the primary critical strategies for success, market expansion, growth and survival of SMEs (Musteen *et al*., 2010; Pangarkar, 2008; Suh and Kim, 2014). Many investigations on internationalized SMEs has determined the main elements which impact global success of the SMEs and their innovation performance determinants in global environment (Raymond and St-Pierre, 2010). As important factors such researches usually have attempted to concentrate on demographics, for example, size of the firm (Fritsch and Meschede, 2001; Moreno and Casillas, 2007) and social capital (Balachandra and Friar, 1997).

Internationalization is identified as business activities which cross domestic borders and generates value in firms (Welch and Luostarinen, 1988). These days internationalization impacts all firms, large and small. Significantly, SMEs are encountering global competition and must play a key role in global markets (Kuada, 2006). Moreover, internationalization is considered as the significant impact of business opportunities maximization and in recent years, a lot of SMEs started internationalization as a business success requirement (Rundh, 2007; Hyari *et al*., 2012).

Malaysian SMEs internationalization: Since, its independent in 1957, the transformation of Malaysian economy has been through various eras and with different drivers as shown in Fig. 1. It has undergone

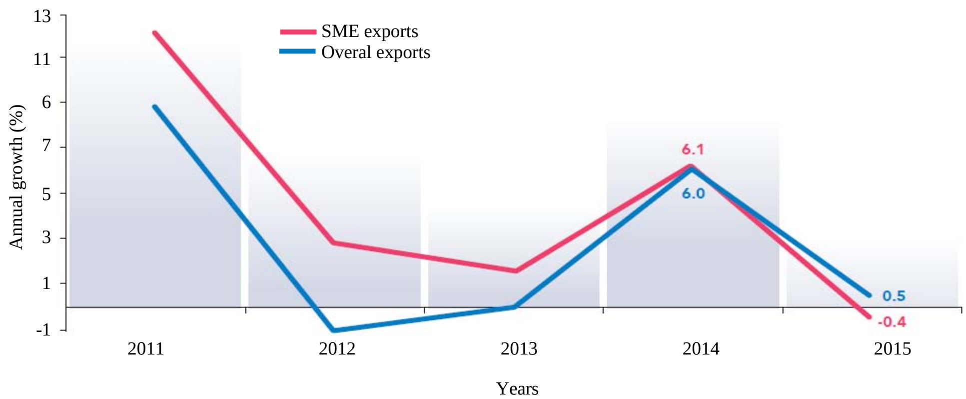

Fig. 2: SMEs export growth (%); SME Corp. Annual Report, 2015/2016

significant structural changes (Jomo, 1990; Okposin *et al.*, 1999), progressing from an agriculture based economy to an industrial production economy and now a knowledge based economy (Yusof and Bhattasali, 2008), driven by innovation and human capital to produce knowledge based goods and services.

Currently, SMEs in Malaysia are highly vulnerable to changes occurring in global economy and there is a need for them to improve their competitive advantage (Shen, 2005; Hilmi *et al.*, 2010). Both Small and Medium firms (SMEs) have a key role in economic growth of the country. Current trend of economic growth as well as rapid industrial development has made Malaysia one of the significant open economies in the world. This country is one of the Newly and successful Industrialized Countries (NICs) that has growing income levels and rapid economic growth as well (Ahmad, 2008; Muhammad *et al.*, 2010; Asgari *et al.*, 2010). Clairmont (1994) called Malaysia as “Unstoppable Tiger”.

Based on the trend in economies of South-East Asia, Malaysian SME sector continues to have a key role in industrialization program of the country and in fact it is the backbone of industrial improvement (Harvie and Lee, 2004; Saleh and Ndubisi, 2006; Hashim, 2000). Located in Southeast Asia, Malaysia developing nation which is promoting SMEs to become global players. Malaysia has many advantages including first class physical infrastructure, political stability and a multilingual, multicultural and skilled workforce. Currently, Malaysia is significantly competitive to attract many direct foreign investments (DFI) and is one of the top 20 trading countries in the world (FMM, 2005). In addition, it is important to create a strong SMEs base if Malaysia is to continue to be highly motivated to generate home-grown Multinational Corporations (MNC). A well-developed local business context also contributes to attract joint ventures between foreign companies and Malaysia. It is mandatory for all of the SMEs to exploit their specific competencies to achieve sustainable competitive advantage and to look for various approaches to improve their overall performance.

There are almost 518.996 SME which represent 99.2% of total business development in Malaysia. Only 5.221 of this total are active exporters accounting for 16.6% of total exports in this country. These SME exporters are primarily active in manufacturing field (57.6%), service (40.6%) and agriculture (1.8%). In 2005, key export destinations for manufactured goods were respectively ASEAN (27.2%), USA (23.4%), European Union (10.4%), Japan (7.4%), Hong Kong (7%), Republic of China (6.1%) and the remaining 18.5% to the rest of the world (EPU, 2006). The statistics provided above demonstrate that economy of Malaysia is highly reliant SME and their rising dependency on global trade.

Malaysia has much work to do before reaching the preferred position of becoming the financial hub in SEA region and promoting the business in the future which is a part of government aspiration in the Economic Transformation Programmes (ETP), Government Transformation Programmes (GTP) and the challenge of the involvement of Malaysia in the Trance Pacific Agreement (TPPA) to increase the SMEs contribution in order to be in line with other developed nations in 2020. One of the current statistics demonstrated that SME of Malaysia covers 19% of total exports and the aim of Malaysia for 2020 is to enhance exports to 25%. Although from 2014 overall percentage of export growth has decreased that is shown in Fig. 2.

RESULTS AND DISCUSSION

Financial problem of SMEs: Capital is important to the survival and operation of any business. All businesses need financial resources to fund growth and trading. Lack of availability or access could be barrier to business growth (Cassar, 2004; Olawale and Garwe, 2010). That business owners can access proper and efficient finance in order to grow is an important concern for all policy makers. When the SMEs have been reappraised as capable entities to contribute to drive the economy in general, many studies concentrated on financial barriers which might impact development and growth of these new businesses (Capizzi *et al*., 2011). Many different investigations revealed that smaller enterprises are faced with more financing barriers through the capital structure spectrum compared to larger ones (Wattanapruttipaisan, 2003; Beck, 2007; Beck and Demirguc-Kunt, 2006; Ramlee and Berma, 2013). Also new SMEs could be financed from the personal wealth of the founders/or by having access to external finance sources which can be informal resources for instance friends and families or from formal market-based sources including Venture Capitalists (VCs), banks and private equity companies.

SMEs require enough financing in order to fulfill the needs in each level of their life cycle from creation toward operation, restructuring, development, recovery and more, in particular at initiation, start up as well as growth (Arokiasamy and Ismail, 2009; Ramlee and Berma, 2013). Limited internal financing resources specifically increases the risks of operation for nascent companies. As a business grows, SMEs will be advised to add more capital to accommodate such expansion.

According to previous studies like (Olawale and Garwe, 2010), firms should move from relying on internal finance to external finance by means of growth. External finance has positive relationship since there will be higher desire to grow so there will be more need to have financial sources. Thus, it can be concluded that firms should look for more financiers if their internal funds are insufficient (Dorin and Ligia, 2007). Thus, growing firms should have more capital for growth. In this regard, one method for the SMEs is to benefit from bank loans. According to previous studies, SMEs have many limitations accessing formal financing compared to large organizations (Wattanapruttipaisan, 2003; Beck, 2007; Beck and Demirguc-Kunt, 2006; Ramlee and Berma, 2013). However, many scholars assert that having access to bank loans is not convenient for the SMEs. Banks do not operate the same way in developing and developed nations, for example in developing economies, banks are not forced to be exposed to SMEs and offer only a small share of bank loans which are available (Beck and Demirguc-Kunt, 2006). Such operation can be a barrier for the SMEs. SMEs usually face many problems because they find it hard to get financing from banks, capital markets or other credit providers. The SMEs cannot fulfill their requirements. The collateral issue is the biggest such requirement that cannot be provided by most SMEs. Those who can access this type of credit may encounter short repayment durations and high rates of interest that make it difficult to initiate any expansion and development projects.

One of the big challenges for SMEs is having access to external financial resources. Research conducted by Salikin demonstrated that insufficiency of capital is the key problem among SMEs which might be because of difficulty acquiring external funds. Many SMEs, unfortunately, encounter the issue of access to finance from the external finance sector. Therefore, access to funds to begin or improve the business can be the main barrier for entrepreneurs (Berger *et al*., 2011).

Many studies which employ firm-level survey data reveal that access to finance as well as cost of credit result in many obstacles to SME (Scholtens, 1999; Schiffer and Weder, 2001; Galindo and Schiantarelli, 2003) similar results have been identified in other investigations: having access to credit card is one of the main barriers for Colombian SMEs (Stephanou and Rodriguez, 2008), limited access to finance and also management, regulation and labor skills are the key barriers to SMEs growth in UK (Binks and Ennew, 1997) lack of ability to increase external finance in Slovenia is one of the key barriers for underdevelopment of SME sector (Hutchinson and Xavier, 2006) limited access to external finance is a big issue in many Central and Eastern European countries (Anderson, 1997; Budina *et al*., 2000; Gros and Suhrcke, 2000; Konings *et al*., 2003) (Fig. 3).

SMEs financing in Malaysia: According to old adage, "all money is not the same" is at some point true for financing of SMEs in Malaysia. SMEs agree that their finance is abundant. In 2005, in Census, Bank Negara Malaysia (BNM) determined that most of the SMEs (57.6%) utilized their internal initiated funds and those funds which are sourced from family or friends in order to finance their activities. Moreover, almost 16.1% of SMEs demonstrated a dependency on finance from Fis (development financial institutions and banking) according to SMIDEC, however, use of equity finance was very low. Figure 4 explains the results from World Bank Enterprise Survey Data, Departments of Statistics Malaysia and Census of Establishment and Enterprises 2005 in more detail.

Many different investigations have identified that savings of founders of SMEs and friends and family

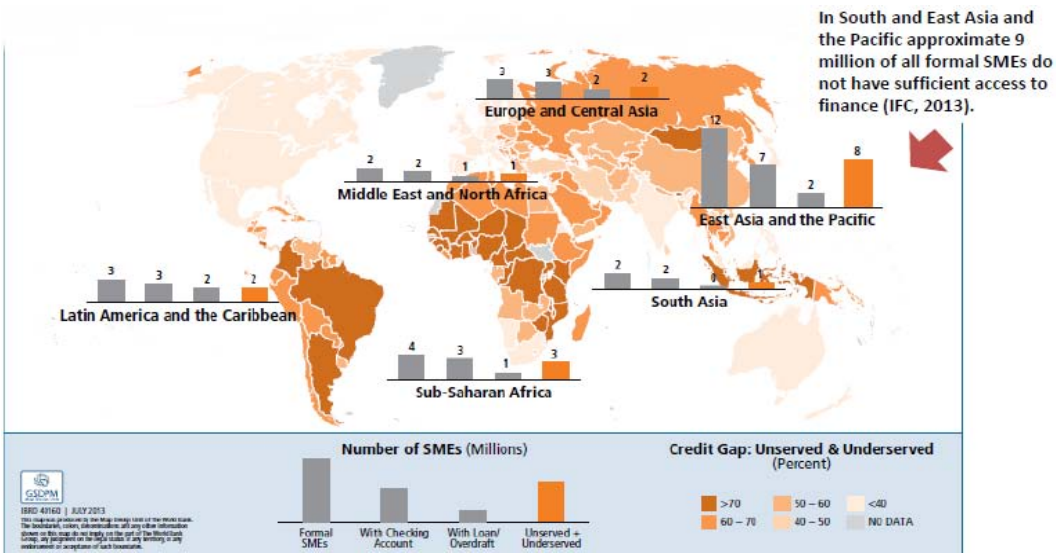

Fig. 3: Formal SMEs Sector Credit Gap IFC (2013)

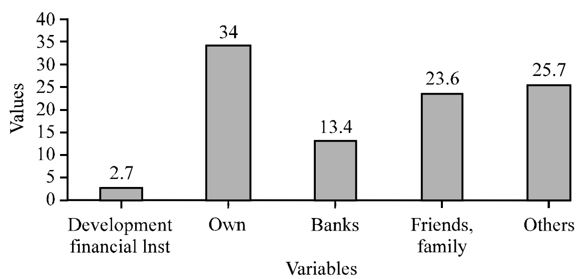

Fig. 4: Malaysian SMEs sources of funding; Bank Negara Malaysia, 2006

assets are the usual basis of capital (Tyebjee and Bruno, 1984; Roberts, 1991). However, the requirements of finance are different in various sectors (Mason and Harrison, 1994). For example, for most of the SMEs profit and internal equity alone are not sufficient to fulfill high requirements for capital to develop and progress toward next stage of growth. Many different studies revealed that SMEs rely on financing from the banks as the primary finance resource in terms of growth inclination.

The annual report of SMEs in Malaysia in 2005 demonstrated that of a total of 523.132 responded establishments, 54.011 mentioned the hardship encountered with acquiring finance from banks. The barriers in front of SMEs are limited collateral (55.2%), limited documents to support application of loans (13.1%), no financial track record (10.7%), long loan processing time (9.8%), no viable business plan of financial institutions (5.3%) as well as others (5.9%) (Fig. 5). Financial problem and SMEs internationalization: some of the elements that can encourage SMEs to penetrate markets abroad are market expansion, obtaining new ideas and more profit generation (OECD, 2009). In addition, obstacles to internationalization between SMEs are lack of capital, shortage of knowledge of potential markets as well as how to penetrate them, managerial attitudes and characteristics (Shih and Wickramasekera, 2011) and limited number of qualified employees (Ortega, 2003; Abdulah *et al*., 2011). The findings demonstrated that resource profiles can differ between non-internationalized and internationalized companies and financial and social resources are more critical compared to human resources for those small firms which follow internationalization strategy.

Many investigations in literature assert that shortage in finance and relevant physical resources are considered as the primary obstacles to SMEs internationalization. The evidence covers all of the disadvantages observed by new Canadian international ventures as well as exporters of early-stage SMEs relative to their more developed counterparts in terms of accessing term loans and operation. Another similar result regarding the financing barriers has been concluded by Australian business planning in their very first global operations. Limited capital requirements as well as other resources of the firm and limited access to important infrastructure has also been mentioned recently by the SMEs observed in Finland, China, India, Ireland, Indonesia, Russia, Spain, South Africa, Turkey as well as Sweden (Lloyd *et al*., 2009).

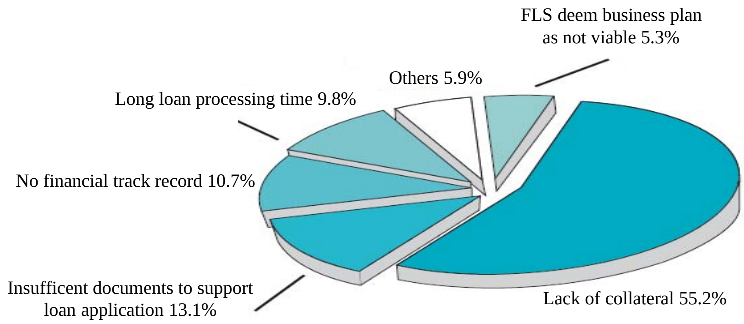

Fig. 5: Constraint Faced by SMEs; census of establishment and enterprise 2005 Department of Statistical Malaysia

Other similar proof has been identified in SMEs where their global diversification was limited through lack of capabilities and resources (Vivekanandan and Rajendran, 2006). According to Xia *et al*. (2007) and Bobillo *et al*. (2007), the organizational assets are key determinants of internationalization of a firm. A recent research conducted in South Africa demonstrated that social capital and financial items of a firm are the critical internationalization factors (Urban, 2012). Also, Central Bank of Malaysia (2003) in case study conducted on SMEs for more than ten years revealed that financial issues, availability and accessibility, are the key barrier for internationalization of SMEs.

Extensive studies on internationalization within SMEs has asserted that newer and smaller firms might encounter challenges in internationalization because accessibility and availabilty to the financial resources (Bonaccorsi, 1992; Oviatt and McDougall, 1994; McDougall and Oviatt, 1996; Westhead *et al*., 2001). In addition, obstacles to internationalization among SMEs are in fact capital shortages (Abdulah *et al*., 2011). The idea that shortage in resources will slow down internationalization is according to a limited conceptualization of organizational resources (Bonaccorsi, 1992). All of the resources might be external or internal to an organization and external resources might have a key role in strategy development of a firm (Bonaccorsi, 1992).

CONCLUSION

Future process of Malaysia appears to be significantly dependent on SMEs development and they are critical for reaching the vision 2020 to be totally developed and to be an industrialized country by 2020 and increasing export rate. Malaysia in 2020 will become an industrialize country through capitalizing on strengths of the country and eliminating the weaknesses by means of SMEs. However, financial problem is one of the biggest problem for SMEs. The existence of finance for SMEs in Malaysia is not problematic in itself because finance sources are abundant. However, the difficulties with adequacy and accessibility of such funds are fragmented and limited.

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