马来西亚华人研究学刊
第 6 期，2003 年，页 101-119

Journal of Malaysian Chinese Studies
Volume 6, 2003: 101-119

THE 1997 FINANCIAL CRISIS AND LOCAL RESPONSES: THE SMALL AND MEDIUM ENTERPRISES IN MALAYSIA*

1997 年金融风暴与当地的应对措施：马来西亚的中小型企业研究

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Abstract

The small and medium enterprises (SMEs) are an important component of the Malaysian manufacturing industry. They were badly affected by the 1997 financial crisis and the effect persisted for two years. While the crisis reflected the defects arising from the liberalization of the financial sector under the process of globalization, it also brought to light the many weaknesses of SMEs. In view of the vulnerability of this sector, the Malaysian government had to persuade the banks and financial institutions to extend various financial packages to assist the SMEs and to restructure the economy. Most SMEs were able to tide over the effects of the crisis and to emerge stronger than before. However, the future of SMEs is still determined by how well the sector will succeed in overcoming various weaknesses that still exist.

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* This is the revised version of a paper presented at the Workshop on "Globalization, National Governance and Local Responses", Georgetown, Penang 17-18 April 2002. The author is grateful to Sida/SAREC of Sweden for funding from the project on Discourses and Practices of Democracy in Southeast Asia.

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摘要

中小型企业是马来西亚制造业的中流砥柱。然而，它们在 1997 年遭到金融风暴的严重打击，就是在两年后也依然未能恢复元气。这场金融风暴正好反映了在全球化过程中，在金融业中冒起的自由主义化的缺点，当然，这在无形中也突出了中小型企业的弱点。为了解决此行业的困境，马来西亚政府说服了银行和金融机构，提供许多财政配套以援助中小型企业，以及重组国家的经济。大部分的中小型企业基本上都得以克服这场风暴的负面影响，展现出比以往更茁壮的实力。无论如何，中小型企业的未来要得到持续的成功，依然决定于这行业如何战胜它们现存的众多弱点。

Introduction

The rapid yet relatively recent industrialization process in Malaysia is heavily reliant on foreign direct investment and it has in turn given rise to a supporting network of primarily locally-owned small and medium enterprises (SMEs). SMEs are defined as companies with fewer than 150 full-time employees and RM25 million in annual turnover in sales. In 1998, they made up about 91 per cent of all manufacturing establishments in the country and more than 80 per cent were established by the Chinese. The SMEs form "the backborn" of the Malaysian manufacturing economy by creating linkages and for supplying component parts and services to heavy industries and other clients. In 2002, the SMEs contributed 28.5 per cent of total output in the manufacturing sector, 26.5 per cent of its added value and 30.7 per cent of its total employment (National Productivity Centre 2002). Despite their importance in the economy, it is nevertheless difficult to verify the number of SMEs in Malaysia. The Small and Medium Industries Development Corporation (SMIDEC) recorded a registered membership of 11,855 in 1999. The Associated Chinese Chamber of Commerce and Industry of Malaysia (ACCCIM), however, claimed to have 24,000 members (*Malaysian Business* 1 January 2001), and Lee and Lee (2003) estimated the number of SMEs in Malaysia at around 20,000.

Like all sectors of the Malaysian economy, the SMEs were severely affected by the financial crisis that swept through East Asia in 1997-98. The basic cause of the crisis could be traced to a combination of complex factors ranging from the structure of the domestic economy to the forces of globalization. The impact of the latter was particularly severe. Globalization compresses time and space by facilitating the easy movement of goods, capital and people across the globe. If one of the characteristics of globalization is the ability to instantly transfer large quantities of capital into and out of national borders, then it is the dark side of this process that also triggered the financial and economic crisis in 1997/98. The frightening speed in which the crisis spread across nations revealed many negative and uncontrollable impacts of globalization. The crisis confirmed that liberalization in the financial sector could create uncertainties and instabilities in the world economy. These are largely the outcome of market-induced mechanisms of the new economic system that manage to bypass national and international regulatory control.

This paper will examine the impact of the financial crisis on SMEs and the strategies adopted on how best to survive the crisis, including various responses adopted by Chinese SMEs. The financial crisis, however, was too overwhelming and complex for the SMEs to cope with single-handedly. Discussed too is the manner in which the government as well as local financial institutions supported the efforts of SMEs to weather the crisis. This article will argue that to moderate the adverse impact of globalization, the role of the state remains important in devising strategic measures such as restructuring the national economy and financial system to protect its business sector. The Malaysian government's intervention to safeguard its economy supports the argument that the nation-state plays a rightful role in the globalization process (Henderson 1989; Weiss 1998).

Data used in this article are derived from the surveys of Chinese-owned SMEs conducted by ACCCIM, Small and Medium Industries Development Corporation (SMIDEC) [1] and personal interviews with 30 Chinese SMEs. Samples in the SMIDEC surveys also include SMEs owned by other ethnic groups.

The Asian Financial Crisis and the SMEs

The financial crisis that spread through a large swathe of Asia from 1997 was a manifestation of the adverse impact of economic globalization that severely undermined the role of governments in economic management and development. In Malaysia, the crisis compromised the long-term economic goal of achieving developed-nation status by 2020. It so interfered with economic, social and political stability as to weaken, if not sap, the economic energy of the country. Economically, Malaysia suffered the worse setback in development when its gross domestic product (GDP) plummeted by 6.7 per cent in 1998 after nine consecutive years of robust growth. The country was literally impoverished by the ferocity of the crisis. Between 2 July 1997 and 1 September 1998, the Malaysian ringgit depreciated by 45.2 per cent in exchange for the US dollar, and the Kuala Lumpur Stock Exchange (KLSE) lost 57.9 per cent or RM421.0 billion of its capitalization (Ong 1999).

Following this, Malaysia's GDP per capita fell 9.0 per cent from RM9,065 in 1997 to RM8,245 in 1998 (Ragayah and Saadiah 2002). In social terms, the crisis disrupted official efforts to achieve a more equitable distribution of the nation's wealth among the ethnic groups. In effect, it exacerbated income differentials and widened disparities in development both within and among different states (Ishak Shari 1999 and 2001). On the other hand, the crisis enabled foreign interests to enhance control of the nation's wealth considerably from 27.7 per cent in 1995 to 31.8 per cent in 1998 and 32.7 per cent in 1999 (Malaysia 1999 and 2001).

Weakened Performance of SMEs

The crisis persisted for several years and affected SMEs negatively on several fronts. These may be briefly examined with reference to the contribution to output in the manufacturing sector, employment and investment.

Making up nine out of ten manufacturing establishments in the country, the SMEs and indeed the entire manufacturing sector suffered from the sharp contraction in domestic and external demand following the economic meltdown from the financial crisis. In a survey by SMIDEC in 1998, the closure of about a tenth of SMEs in the manufacturing sector was attributed to the financial crisis. The contribution of SMEs to the manufacturing output fell from 17.0 per cent in 1997 to 15.8 per cent in 1998. In terms of employment, whereas the SMEs had vastly expanded its role as a source of employment when its share of the manufacturing workforce rose sharply from 17.4 per cent in 1996 to 30.6 per cent in 1997, this role was effectively checked by the crisis when its employment share stagnated at 29.9 per cent in the following year (National Productivity Centre 1996 and 1998). In 1996, SMEs employed 563,596 workers, hence a drop of 0.1% in employment would put 564 persons out of work (SMIDEC 2002).

Following various cost-cutting measures and productivity improvement efforts adopted by SMEs during the course of the crisis, the sector began to register gains in productivity. The sector's contribution to total manufacturing output increased from 15.8 per cent in 1998 to 18.9 per cent in 1999 and jumped substantially to 24.4 per cent in 2000 (MITI 1999 and 2000). The SMIDEC survey in 1998 revealed that only 12.4 per cent of SMEs rated their performance as "good", 40.2 per cent "fair", 39.2 per cent "bad" and 8.2 per cent "worse". More than half of the SMEs that rated their performance as "good" were in the resource-based sector. The most badly affected were companies in the machinery and engineering and transport equipment industries (Table 1).

Table 1. Performance of SMEs Companies, 1998 (per cent)

Percentage	Sector				Total
	Electrical and Electronic	Machinery and Engineering	Transportation and Equipment	Resource-based	
Good	7.3	12.5	7.7	22.2	12.4
Fair	43.9	25.0	38.5	44.5	40.2
Bad	41.5	56.2	46.1	22.2	39.2
Worse	7.3	6.3	7.7	11.1	8.2
Total	100.0	100.0	100.0	100.0	100.0

Source: SMIDEC 1998

The disincentive to invest was clearly evident. There were 179 applications in 1997 involving capital investments of RM495.951 million, but both fell drastically in 1998 when 108 applications proposing an investment of RM212.251 million were received. Applications from foreign sources dropped by 39 per cent from RM103.36 million to RM63.04 million (SMIDEC 1998). Investment in the sector continued to decline in 1999 with only 93 applications received. However, an increase in investment totalling RM231 million indicated that some SMEs were recovering from the crisis and were therefore more confident to undertake investments in new as well as expansion projects (MITI 2000).

Major Factors Affecting Business Performance of SMEs

The contraction in both domestic and external demand caused by the regional financial crisis dented the performance of the SME sector. The depreciating ringgit and tight liquidity from the third quarter of 1997 saddled SMEs with escalating operating costs and cash flow problems. The surveys by SMIDEC (1998) and ACCCIM (1999 [2], 2000 [3] and 2001 [4]) on economy recovery in Malaysia highlighted several important findings on the performance of the SMEs.

Currency Instability

The ringgit slipped from RM2.50 to US$1 to RM2.61 on July 14, 1997 and thereafter rather steadily to RM2.83 on August 12, RM3.00 on September 2, but slumped to RM4.88 on January 7, 1998. By the middle of the year, poor local corporate performance and negative developments in Japan kept the exchange value of the ringgit low at RM4.16 on 8 July 1998 (NERP 1998). Many SMEs paid heavy penalties from the appreciation of foreign currencies in the purchase of raw materials, machinery, and equipment, acquisition of components and other requirements. Half of the SMEs affected by the crisis transacted in US dollars, a fifth in Singapore dollars and 8 per cent each in Japanese yen and German marks (SMIDEC 1998).

Decline in Foreign and Domestic Demand

Currency depreciation weighted most heavily on SMEs that relied on the domestic market but imported most of their inputs in US currency. On the other hand, export-oriented SMEs such as those in the resource-based and electrical and electronic sectors benefited from enhanced sales and performed better than before (SMIDEC 1998).

In a survey by ACCCIM in 1999, 18 per cent of the 293 respondents cited weak demand as the primary cause of their poor performance in the second half of 1998. Three major factors were responsible for the decline in foreign and domestic demand in 1998. Firstly, the decline could be due to cautious spending in view of uncertain domestic economic circumstances in the third quarter of 1998 after the announcement of capital control. Foreign trading partners hesitated in sealing their contracts with local corporations both before and immediately after capital and exchange controls came into effect. Secondly, even after the implementation of capital and exchange controls in early September, the domestic economic scenario remained uncertain with thc sacking of the then Deputy Prime Minister-cum-Finance Minister. Lastly, the depressed stock market (KLSE reached 262 points at one stage) and property market created asset liabilities and forced consumers to trim their expenditure in preparation for uncertainties in future earnings (ACCCIM 1999).

The shrinkage in foreign and domestic demand remained a lingering obstacle to improved business performance of 46 per cent of SMEs in 2000 and 50 per cent in 2001 (ACCCIM 2000 and 2001). The lacklustre performance of the local stock market was also indicative of overall caution in spending. The slackening world economic growth to about 2.9 per cent in 2001 compared with 4.8 per cent in 2000, due largely to the slowdown in the US economy and the semiconductor industry, prompted the softening of foreign demand.

Domestic Competition

The ACCCIM survey of SMEs in 1999 reported that 13 per cent of the respondents cited domestic competition as a major factor in their business performance. Increased domestic competition had emerged in different forms. Local corporations and traders resorted to price-cutting sometimes to below cost in an effort to raise cash to tide them over the economic crisis. Falling foreign orders led to keener competition for a share of the domestic market. Certain export-oriented companies also dumped their goods in the local market to the detriment of local SMEs.

To cope with the increasing competition and deliberate lowering of market prices, many SMEs had to adopt stringent measures to avoid going out of business. A study of 30 Chinese SMEs in 2003 showed that many had to resort to dealing only in cash and denying credit terms except to long-time customers. They avoided commitments on properties but made investments in machineries to increase productivity (Chin 2003). SMEs were facing increased competition because of consumer selectivity in purchases, price-cutting by competitors to generate cash for fear of further worsening of the economy, and the influx of cheap basic consumer items resulting from trade liberalization under the ASEAN Free Trade Area and WTO agreements. Hence 37 per cent of SMEs in the 2001 ACCCIM study sample confirmed the adverse effect of increased competition in the domestic market. A survey of 100 SMEs in Penang by Socio-Economic and Environmental Research Institute indicated that this trend persisted into 2003.

Cash Flow Problems and Dependence on Imported Raw Materials

Three out of every ten SMEs faced severe cash flow problems arising from the ringgit depreciation and had to tolerate credit terms of 100 days or more for purchases by their clients. My own study with selected SMEs revealed that some incurred losses owing to failure to recover credit ranging from RM100,000 to RM1 million. Hence many were forced to borrow from banks to overcome financial constraints.

The ability of SMEs to adjust to the financial crisis was also hampered by the reliance on foreign sources of raw materials and equipment (SMIDEC 1998). Much affected were manufacturers whose imported raw materials rose in price in tandem with the depreciation of the ringgit. Finished goods that comprised imported components were rendered less competitive both domestically and internationally with consequent erosion of profitability (ACCCIM 1999). On the other hand, the ringgit depreciation enhanced the competitiveness of Malaysian exports to trading partners whose currencies had gained substantially on the ringgit.

Until the first half of 2000, escalating operating and raw material costs continued to plague business performance, and 46 per cent of the 332 respondents cited this as a major problem. The pegging of the ringgit to the US dollar at a fixed rate of RM3.80 in late 1998 sustained the increase in the costs of imported raw materials and components (ACCCIM 2000).

Other factors that dented business performance and cited by the ACCCIM reports included management style (12 per cent), government policies (11 per cent), and others such as the domestic political situation (5 per cent). For management style, the Chinese Chamber of Commerce and Industry of Kuala Lumpur and Selangor believed that the Chinese business community would survive the crisis because they have a fundamentally strong foundation in business (*Utusan Melayu* 10, January 1998). The Chinese business community is also generally more conservative and prudent in their business transactions. The relatively low level of borrowing also enabled Chinese businessmen some flexibility in making adjustments to cope with uncertainties. It is also believed that the moderate scale of operation of SMEs made for ready adjustment to management and production in response to changing circumstances (ACCCIM 1998).

SME Response to the Regional Economic Crisis

The regional economic crisis was a test of which only the "fittest" business concerns could survive. Like other manufacturing enterprises, SMEs responded to the challenge through the adoption of two broad strategies. The first was the use of contingency measures to tide over the immediate problem of survival and the other was a longer-term objective of strengthening the business foundation based on sound principles of governance. An ACCCIM survey provides insights on how Chinese SMEs dealt with the protracted economic crisis in the first half of 1999 (see Table 2).

Strengthening Competitiveness

The ability to withstand competition featured significantly in company strategies to survive. As shown in Table 2, the need to strengthen competitiveness

Table 2. Response by Chinese SMEs in the First Half of 1999

Response	1st half of 1999 (percentage)
1. Enhance competitiveness to increase market share	19
2. Implement more stringent cost control measures	17
3. Continue the existing size of operation, wait and see until Malaysian and world economies stabilize	20
4. Explore and evaluate suitable investment and expansion opportunities	8
5. Increase borrowings	-
6. Increase export	6
7. Reduce production/ down-sizing the operation	9
8. Other forms of response	21
Total	100

Source: ACCCIM 1999.

was considered by 36 per cent of the respondents in the 1999 ACCCIM survey. Among ways to enhance competitiveness included attempts to expand market share and to use more effective cost control measures. Both these remained the major measures taken by the SMEs up to the first half of 2000 (ACCCIM 2000). Improvement in the quality of management was also mentioned though on rather rare occasions. [5]

Continue Existing Operations and Explore Business Opportunities

A fifth of the respondents would maintain their existing size of operations and to wait for better times and only 8 per cent planned to explore suitable investments and expansion opportunities (Table 2). Continued lack of optimism in 1999 and that most enterprises were stagnant or even declining were the reasons for the low percentages. By the first half of 2000, a quarter of SMEs still adopted a "wait and see" attitude but was cautiously optimistic with economic prospects in the second half of the year (ACCCIM 2000). Companies that continued with their existing size of operation would trim cost by salary deductions, upgrade employee skill and knowledge, and strengthen competitiveness to increase their market share. Only 6 per cent attempted to increase their export in the first half of 1999 and none increased their borrowings.

Down–sizing Operation and Retrenchment

Under the testing circumstances of the crisis, most companies shelved their expansion plan or consolidated their businesses rather than to lay off workers (Chin 2003). The economic downturn forced 9 per cent of the respondents to scale down their productions as demand shrank (Table 2). My own study showed that only two companies scaled down operation. In rare cases, enterprises were forced to hive off "side" interests in an attempt to consolidate their core business.

A survey by SMIDEC in 1998 revealed that one of the immediate actions taken by SMEs was the retrenchment of workers as a response to the financial crisis in 1997. This was especially so in the electrical and electronic as well as the machinery and engineering sectors, while the transportation and equipment sector remained unaffected (see Table 3). Another measure, reported by 62 per cent of SMEs, was to seek alternative sources of raw materials and to diversify their market rather than be dependent on vendor arrangements. However, retrenchment was largely subordinate to the sourcing of raw material supply and market diversification as measures to cope with the economic downturn.

Table 3. Retrenchment of Workers by SMEs, 1997 and 1998 (per cent)

Percentage	Sector								Total	
	Electrical and electronic		Machinery and engineering		Transportation and equipment		Resource-based			
	1997	1998	1997	1998	1997	1998	1997	1998	1997	1998
0-20	66.7	60.0	100.0	66.7	0	0	50.0	0	66.7	45.5
21-40	33.3	0	0	33.3	0	0	0	0	16.7	9.1
41-60	0	40.0	0	0	0	0	50.0	66.7	16.7	36.3
61-80	0	0	0	0	0	0	0	33.3	0	9.1
81-100	0	0	0	0	0	0	0	0	0	0
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: SMIDEC, June 1998.

Alternative Arrangements

No clues were revealed by official or local business reports on how the business community received help from other sources such as the family or loan syndicates. Among Chinese SMEs that had suffered heavily from the crisis, those that had no access to alternative sources of funding became bankrupt or liquidated their operations to settle their debts as banks, especially foreign ones, demanded repayment or reduced their loans. However there were enterprises that survived through moderate loans of RM100,000 or so extended by the family or relatives.[6]

A few enterprises that failed to secure loans from the government resorted to borrowing from local loan syndicates. Most of these syndicates operate outside the law and levy exorbitant interest rates of 12-16 per cent per annum. Notorious in the use of threat in the recovery of their principals and interests, these syndicates have become a menace and the indebted often paid heavy penalties for their indiscretion (see, for example, *The Star*, 24 March 2002).

Response of the State

The manner of the Malaysian government response to the crisis has been widely documented. The government has been praised for its distinctively "Malaysian" solution to the crisis as well as condemned, especially in the West, for its unconventional approach. The government took immediate and rather bold steps in the form of the National Economic Recovery Plan (NERP) in August 1998 to deal with the economic crisis.[7] .Rather than to look upon this as a state-led approach, it may be more appropriate to consider it as a state-induced strategy to the solution of economic problems under unusual circumstances. This strategy involved a series of policy measures to face the financial crisis and to stabilize the economy. Many have acknowledged that these measures have begun to yield some positive results, as indicated by statistics released by international institutions as well as the Malaysian Institute of Economic Research (see Ragayah 2003). In general, the Chinese business community has strongly endorsed the measures advocated by the NERP in reviving the economy (ACCCIM 1998).

Macro–level Solution

The government's initial response to the economic crisis as announced in the 1998 Budget on 17 October 1997 was to reduce federal government expenditure by 2 per cent, deferment of mega projects, and review of purchases of foreign goods by public agencies; shorten the default period for classification of non-performing loans (NPLs) from six to three months, and impose a limit on overall credit growth to 25 per cent by the end of 1997 and 15 per cent by 1998. In providing loans, banking institutions were to give priority to productive and export-oriented activities (NERP 1998).

The government further introduced pre-emptive measures to shore up the resilience of the financial sector and all aspects of the financial system through various means. These included the establishment of Pengurusan Danaharta Nasional Bhd, the national asset management company, to acquire and manage NPLs of banks, and the Danamodal Nasional Bhd, a special purpose vehicle to revitalize and restructure the banking sector by purchasing NPLs from banks and to recapitalize them. A Corporate Debt Restructuring Committee was set up to guide the recapitalization process and to preserve and facilitate debt restructuring of viable companies. It is now acknowledged that the government responded rather quickly and efficiently in restructuring the banking system via Danamodal and Danaharta. As Malaysia's national asset management company, Danaharta has acquired and managed a total of RM19.73 billion worth of NPLs as at December 31 1998, exceeding its target of RM14 billion (*NST*, 17 March 1999).

To stabilize the financial market, the government adopted temporary capital controls on September 1, 1998 to restrict the outflow of funds and to insulate the economy from external risks and vulnerabilities by pegging the ringgit at RM3.80 to the US dollar. These measure were significant in two respects. By stemming the outflow of capital, it reputedly saved the economy, and hence the SMEs, from ruins. It also made Malaysian exports more competitive and benefited SMEs that sold their products abroad (Lee and Lee 2003). A further step taken by the government was to create a greater breathing space for all sectors with the exemption taxation in 1999 as a fiscal stimulus. This measure stimulated improvements in productivity and sales, and at the same time acting as a powerful disincentive for capital flight. In March 2001 the government launched a RM3 billion package to stimulate the economy. Following the September 11 terrorist attack in New York, the government spent a further RM4.3 billion as a booster to soften the impact of the global slowdown on Malaysia (*The Star*, 26 September 2001).

Assistance to SMEs

Official concern for the SMEs assumed various forms. One was access to financial assistance for viable SMEs that faced the problems of credit squeeze, increased production costs, cash-flow bottlenecks, and stringent credit terms from banks and creditors. The government instituted special funding to SMEs to sustain their operation, to improve productivity, and to facilitate expansion and diversification plans. Major funds introduced included those administered by Bank Negara Malaysia (the Central Bank), namely, the Financial Package for SMEs (PAKSI), Funds for SMEs, Rehabilitation Fund for SMEs, Special Scheme for low- and medium-cost houses, and Japan's Overseas Economic Cooperation Fund.

PAKSI set aside RM50 million in October 1997 to provide soft loans for "project financing" and "working capital financing". Project financing was meant to enable SMEs to undertake either new projects or expand and diversify existing ones. The working capital scheme provided financing for the purchase of raw materials, components and parts, inventory of finished goods as well as to meet labour cost. However, by the end of 2000, only 52 out of 209 applications were approved with loans valued at RM30.3 million. Rejected were applications from many companies encumbered with legal actions, NPLs or poor financial track records (MITI 2000).

The "Fund for SMEs" scheme allocated a sum of RM1 billion on January 1, 1998 to alleviate the plight of SMEs by helping them to finance existing business or embark on expansion, diversification or for exports. The allocation was raised to RM1.5 billion in May and conditions for approval were revised to make this Fund more accessible to SMEs. The minimum loan amount was reduced from RM250,000 to RM50,000, while the ceiling was raised from RM2 million to RM5 million. SMEs reacted favourably to these changes and by April 1999 the number of approved applications totalled 1,718 for an aggregate loan amount of RM1,455 million (Table 4). The manufacturing sector secured 63 per cent of the loan. Another measure was the "special scheme for low- and medium-cost houses" introduced in May 1998 with the aim to encourage development of low- and medium-cost houses that cost RM150,000 or less.

Table 4. Fund for SMEs (approved by sector as at 30 April 1999)

Sector	Total application	Total (RM million)
Manufacturing	905	917.9
Services	615	344.2
Agro-based industries	198	193.8
Total	1,718	1,455.9

Source: *Berita Harian*, 5 May 1999.

Due to the severity of the financial crisis, many SMEs struggled to meet existing loan commitments. On 23rd November 1998, the government launched the RM750 million Rehabilitation Fund for SMEs to provide financial assistance to viable SMEs that were saddled with NPLs and temporary cash flow problems. The fund targeted SMEs with a capital of less than RM10 million in the manufacturing, agro-based, and services sectors. In early 1999, the government sealed a loan agreement with Japan's Overseas Economic Cooperation Fund to add yet another source of funding to the SMEs (*The Star*, 25 June 1999). Under this scheme, 16.296 billion yen (approximately RM500 million) was made available from June 1999 as credit facilities in the form of loans to SMEs in the manufacturing and services sectors and in agro-based industries. Loans became more available after Bank Negara Malaysia set a minimum lending growth of 8 per cent for 1998 and 1999. In 1999 many SMEs were back in operation after enjoying easier loan approvals to expand their capacity and production.

Additionally, the Ministry of International Trade and Industry widened the definition of SMEs in the manufacturing sector on 19 January 1998 to include enterprises that employed not more than 150 full-time workers and annual sales up to RM25 million. Prior to this change, SME status was accorded only to enterprises with less than 75 permanent employees and shareholder funds of not more than RM2.5 million. This redefinition provided the impetus for SMEs to expand and yet continue to qualify for official loans and other forms of assistance (*The Star*, 19 January 1998). This move would also help to facilitate a more focused approach in developing SMEs, tighten the links between SMEs and large enterprises, and to encourage entry into the export market (ACCCIM, February 1998).

Available data indicate that official stimulus packages to counter the economic slowdown have been beneficial to SMEs especially those that serve the domestic market or use local resources in their production. As for export-oriented industries dealing with electrical/electronics and furniture, the damage caused by the weak global demand was considerable (*The Edge*, 21 January 2002).

Despite the provision of different sources of funding, many enterprises failed to substantiate their requirement for loans and the viability of their business operations. The successful ones were those which put forward convincing proposals that articulated definite and realistic goals and a practical business approach as well as demonstrated a knowledge of their products and the market (*Malaysian Enterprise*, 1 September-October 1999).[7]

Response of Banks

Banks were less sensitive in their response to the financial plight of the SMEs. At the height of the economic crisis, many SMEs had difficulties in securing loans from commercial banks. Prior to the crisis, borrowing from domestic banks and other financial institutions comprised 38 per cent of short-term and 43 per cent of long-term credit (Lee and Lee 2003). However, these percentages were reduced considerably after the outbreak of the crisis. Banks would provide loans only to companies with viable businesses and they tightened their terms at times of deteriorating economic outlook. They were very cautious in advancing loans, especially when an increasing proportion of loans turned out to be "non-performing", and demanded guaranteed collaterals to protect their own interests.

Banks are still selective in lending to SMEs but the rate of approval has improved with their increased understanding of individual industries. Banks used to hold preconceived notions of certain industries and tended to overlook the viability of individual businesses (*The Edge*, 21 January 2002). The government intervention with Bank Negara to set a minimum growth target in lending of 8 per cent for both 1998 and 1999 prompted some local and foreign banks to give out more loans to SMEs. Some local banks also took proactive steps through promoting government-aided loan schemes to SMEs. Maybank, the biggest bank in the country, approved loans to SMEs amounting to RM4.3 billion in 2000 alone and has cumulated an existing SME portfolio of RM15.3 billion in outstanding loans. On its staff are specially-trained loan officers to serve the SMEs and to help out in such tasks as formulating their business plans and to develop closer co-operation with them to minimize business-related risks as well as NPLs (*Business Times*, 11 October 2001). Foreign banks too realized the special need for personalized attention in their service to the SME sector. Standard and Chartered Bank, for example, has started a business financial division in dealing with the SMEs (*The Star*, 22 February 2002).

The Future of SMEs

The financial crisis of 1997 is a harsh reminder of the dark side of economic globalization. The unfettered freedom envisaged by the globalization process and its attendant negative impact on the economies of developing countries should not be accepted unreservedly. While globalization cannot be checked, some of its destructive impacts can at least be subjected to some degree of regulation and control so that developing countries can partake in global economic activities on meaningful terms. Until globalization is a more benign force, the state still has a vital role to play. Malaysia has amply demonstrated that the government is justified in attempts to adopt measures that are not entirely market-driven but serve national interests. The central piece of government measure is capital and exchange control and others include the restructuring of the banking system and the corporate sector, and the injection of substantial sums of capital to revitalize strategic sectors of the economy including the SMEs. Despite unease in the forceful official initiatives in apparent interference with market forces (Ragayah 2003), the role of the state is important in contributing efforts aimed at the management of "damage control". However, as the economy regains its vibrancy, a return to market-based approaches to economic restructuring is almost inevitable.

The SME sector has come under attempts in restructuring and has become more robust and adaptable to future challenges after the bitter lessons of the financial crisis. However, having weathered the crisis, the sector as a whole is still saddled with many inherent weaknesses. Local SMEs are still heavily dependent on the use of US and Singapore currencies in their transactions and often to their own disadvantage. If alternative currencies such as the Euro are used in business transactions among trading partners in Southeast Asia in the future, it would benefit not only the SMEs but also big enterprises and all the countries in this region.

In terms of market share, local SME products are largely traded in the domestic market. The future of SMEs must be made more secure through the expansion of market share abroad. This will help to reduce competition in the crowded domestic market and contribute towards making the SMEs more cost-efficient and price competitive through enhanced productivity levels and management efficiency. With new market forces coming into play as a result of trade liberalization through WTO and ASEAN Free Trade Area, local SMEs must constantly adopt new marketing strategies to sustain profitable operation. By doing so local SMEs would continue their presence in the domestic market despite the importation of competitive goods.

Other weaknesses that undermine profitability of SMEs include the problem of expansion into non-core businesses for quick returns. In so doing, SMEs are deprived of necessary funds for reinvestment to consolidate their core businesses through upgrading skills and technology and commitment to research and development. Indeed the future of local SMEs will be compromised by a serious lack of plans for technological transformation and management improvements that are essential to remain profitable in an increasingly competitive global market. SME entrepreneurs must have the foresight to adopt and innovate to remain competitive. They need to improve product quality and meet international standards and specifications to gain acceptance in a demanding market. At the same time, the state can play a useful role to making available incentives that would facilitate SMEs to move up the technological ladder. Furthermore, active official involvement in developing information technology infrastructure and the promotion of e-commerce is indispensable to assist SMEs to keep abreast of the latest trends in the market.

In the emerging economic scenario in which "size does matter", SMEs would need to co-ordinate efforts with the state to develop selected SMEs towards becoming potential large-scale industries (see Chin 2002). Many Chinese-owned SMEs remain small on account of disincentives imposed by existing regulations such as the Industrial Coordination Act. Relaxations of restrictions of an earlier age are essential to allow SMEs to face new economic challenges. It must be realized that Malaysians are no longer competing with each other but with the world. The state need to periodically review its strategies and policies to meet changing economic circumstance, not least in the SME sector. The state and private capital can develop a smart partnership to promote joint ventures between different ethnic groups in Malaysia and to turn SMEs into large-scale industries that are cost effective and able to take advantage of the increasingly open and highly competitive world market.

Notes

1. An agency of the Ministry of International Trade and Industry, established in 1996 to support the development of SMEs by providing effective leadership in planning and overall coordination (Malaysia 2001).
2. The ACCCIM survey on economic recovery in Malaysia 1999 was based on 293 respondents (37 per cent of the total questionnaires sent) of which 62 per cent were SMEs mainly from wholesale and retail, manufacturing, and construction and real estate sectors.
3. The ACCCIM survey for the first half of 2000 was based on 332 respondents (37 per cent of the total questionnaires sent). Three quarters of the respondents were SMEs out of which 63 per cent were domestic market oriented.
4. The ACCCIM survey for the first half of 2001 was based on 252 respondents (31 per cent of the total questionnaires sent), of which 71 per cent were SMEs. Three-fifths of these SMEs were dependent on the domestic market.
5. From my personal investigation, "quality management", as mentioned by a respondent in the steel galvanizing industry depending on importing of raw materials such as chemicals and zinc, would be to bring down the stock, cut down slow-moving stock to less than six months, practise the just-in-time principle, increase productivity and efficiency, as well as to deal largely in cash, intensify efforts to collect debts and be prudent in extending credit, and to impose a 5 per cent deduction of salary.
6. One respondent claimed that he struck a lottery that paid over RM200,000 and enabled him a temporary breathing space.
7. One of my 30 informants succeeded in securing a loan of RM300,000 from the Fund for SMEs on account of the nature of his business in the manufacture of furniture products, the emphasis on export, and his ability to present a convincing business proposal.

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