

# FACTORS THAT INFLUENCE THE GROWTH PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES (SMEs) IN MALAYSIA

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**Abstract:** *SMEs have been the backbone of a country's economy and there have been numerous studies on SMEs from the past researches. In most studies, SMEs performance is linked with financial management variables, but very limited studies have been conducted on productivity (labour productivity) with SMEs growth performance in Malaysia. The reason productivity management is represented by labour productivity was studied in this research because in order for Malaysia to become a high-income nation by the year 2020, the SMEs need to shift from input driven to productivity driven development, which requires strong measures to uplift its labour productivity. This study examined the factors that influence the growth performance of SMEs in Malaysia, especially for non-listed private limited companies for the year 2014-2018. This research studied the relationship between the working capital management (accounts receivable period), asset management (total asset turnover), production management (value added labour productivity) and cash flow management (free cash flow) with the growth performance of SMEs in Malaysia. The SMEs performance is represented by ROCE and growth is represented by sales growth. Panel data analysis using E-view was used to analyse the data which consists of 256 samples of SMEs from manufacturing, service, agriculture, construction and mining and quarry sectors in Malaysia. From this research it was found that productivity management and working capital management have a significant influence towards sales growth. Meanwhile it was also found that there was a significant influence between productivity management and asset management towards ROCE.*

**Keywords:** *productivity, asset management, cash flow, working capital, ROCE and sales growth*

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## Introduction

In Malaysia, the role of SMEs is considered as the backbone of the economy (Radam Aalias, 2008). Small and medium-sized enterprises play a vital role in the economic development of a country. In particular, in the developing countries where poverty, unemployment, low income per capita, low literacy, high inflation and interest rates can hinder the economic growth of such countries; SMEs contribute significantly to the national income and provide employment opportunities (Ghoneim, 2003 & Moktan, 2007). On the other hand, SMEs have lower survival rates than large firms because of resource constraints (Beck *et al.*, 2005). In Malaysia, SMEs has played an important role in the country's economy force. They are the main contributor to the economy and workforce in Malaysia.

Existing literatures have emphasised various challenges that face SMEs ranging from low productivity, lack of managerial skills, and access to credit, difficulty in accessing technology; to heavy regulatory burden against SMEs (Lucky & Ousegun, 2012; Radam, Abu & Abdullah, 2008). In a study conducted in Ghana, financial management was regarded as the main cause of business failure among SMEs and the most common problem identified were related to inadequate capital, cash flow management and inventory control (Agyei-Mensah, 2010). Researchers such as Decker, Scheiefer & Bulander (2006), Khalique Isa, Shaari & Ageel (2011) and Siringoringo, Prihandoko, Trintri and Kowanda (2009) agreed that, other than financial constraints, there are other matters that put SMEs in high risk and stake. According to the SME Corp report (2016/17), the SMEs in Malaysia are low in productivity compared to larger firms. For instance, the labour productivity of SMEs in 2016 was 3% compared to the productivity of large firms which is 5.1%. Large firms were 3.3 times more productive than the SMEs in 2016 given that the SMEs highly relied on labour input, particularly from the service sector. Due to higher failure rates and low productivity, the SMEs in Malaysia are not competitive in the local and global markets and subsequently this may affect the SMEs growth performance. This research studies on the financial and non financial factors that affect the SMEs growth performance in Malaysia. It highlights the significant relationships between the financial factors (working capital, profitability and cash flow and the non financial factor (productivity) with SMEs growth (sales growth) and performance (ROCE).

## Problem Statement

Even though many programmes have been implemented to improve the productivity, Malaysia still falls behind many high income countries. For example Malaysia's labour productivity level was 32% that of the United States and 56% that of South Korea's in 2013 (Eleventh Malaysia Plan 2016-2020). The productivity growth of SMEs in Malaysia has decreased to negative 6.6% for the year 2014 compared to 3.2% for the year 2011 (Department of Statistics, Malaysia and SME Corp. Malaysia 2014/15). The average labour productivity of SMEs between 2011 and 2013 was RM50, 818 per worker, which is lower than the national average productivity level at RM59, 131 per worker for the same period (based on 2005 prices). However, the productivity level of SMEs in the services sector was lower at RM47, 699 per worker. However, the labour productivity has been decreasing in Malaysia due to the worldwide economic crisis in the last quarter of 2008, compared to nations like the United States (US), Ireland, Australia, Republic of Korea, and New Zealand. Malaysia has been lagging behind China, India, and Indonesia (Wye, Chung-Khain; Ismail, Rahnmh, June 2012). Currently the SME productivity in Malaysia is really low at US\$15, 000 per worker while countries like Singapore are going at US\$55, 000 per worker is clarified by Karunajothi Kandasamy, the senior manager of economic and policy planning of SME Corporation Malaysia (SME Corp). The factors that contribute to lower

productivity levels include low value added services sectors, depending too much on foreign labour and high labour intensive sectors (Borneo Post Online 2012). The insufficient research and development effort in adventuring into labour productivity has been identified as the barrier to growth. This study will look at the impact of the productivity management with the growth performance among SMEs in Malaysia.

### **Research Objective**

To examine the relationship between productivity management, working capital management, asset management and cash flow management with the growth performance of SMEs in Malaysia.

## **Literature Review**

### **Working Capital Management**

The majority of researchers is focused on discovering the efficiency of working capital management and there a considerably many literature exists related to this topic. Based on a study done by Raheman, Afza, Qayyum and Bodla (2010) if the firms in Pakistan employ competent finance staffs, the efficiency in WCM can be improved by regularly collecting debt from their debtors. Firms particularly have problems when come to collection of payment from their customers because the majority of them take a very long time to pay up. Mohamad Azam *et al.* (2011) worked on 172 listed companies in Malaysia for the year 2003 to 2007, to analyse the working capital management and their firm performance. Based on their evidence, it is found that current assets to total asset ratio is positively significant to firm performance. In the investigation conducted by Appuhami (2011) liquidity seemed to be an important factor for firms prefers to invest to obtain growth performance. It was also reported that the liquidity variables relates positively to investments A study on credit collection policy was conducted by Zainudin (2008) on 279 firms in Malaysia. According to the researcher an effective credit collection period, will improve the firm performance and due to this some sectors experience better performance than those who do not manage the collection period adequately. Yazdanfar and Ohman (2016) carried out a study using a large cross sectional panel data set covering 15,897 Swedish SMEs in five industrial sectors from 2009 to 2012 in order to find out the impact of trade credit on profitability among the SMEs. Onuorah and Ifeacho (2017) investigated the effect of credit management on the profitability of manufacturing firms in Nigeria. The results of the study, which used some selected companies, listed on the Nigerian Stock Exchange as sample and covering the period from 2010 to 2014, show that credit policy and liquidity management are negatively correlated with return on assets.

### **Asset Management**

Based on the study made by Ellis (1998), the maximum usage of assets is clarified as effective when the asset is able to maximise its production. Assets which are under-used will lead to company losses because the asset that has been purchased may not be able to produce maximum output, and the cost of purchasing of those assets will increase capital expenditure costs as well. Fleming, Heaney and McCosker (2005) argued that under-used assets may lead to increase in agency costs because the managers will not act in best concern of the owners' interest. Okwo (2012) reviewed on the investment in fixed assets and firm profitability and subsequently claimed that there is an insignificant positive relationship between them. In a survey conducted by Xu and Xu (2013), asset structure and firm performance are positively correlated. Moreover, Jose *et al.* (2010), Wu *et al.* (2010) and Seema *et al.* (2011) claimed that using asset at a

maximum level has a significant effect on the establishment financial performance. Total asset turnover (TAT) is used to measure the ability of the company using its assets in generating total net sales. If the company can efficiently use the entire assets, then it can able to support sales activities. This indicates that the better performance of the company, therefore the investors are interested to invest their money, so it can increase its profit. In a study conducted by Jan (2011), if TAT is higher it means that the company has improved its efficiency and able more sales of assets. If the ratio is lower, the firm might be experiencing lower sales or under-utilising its assets or other internal or external reasons., The firm's credit balance too high if the creditors takes longer time than usual to pay. Based on the research done by Nurlaela (2019), The results of the t-test hypothesis show that the capital structure variable debt to equity ratio (DER), liquidity current ratio (CR), and asset turnover (TATO) have a significant effect on financial performance (return on assets).

### **Productivity Management**

Productivity management measures the connection between the yield (the measure of products and ventures delivered) and input (the amount of work, capital and material assets used to create the yield). Generally, productivity, administration perceives and gathers the yield information concentrates on the physical amount (e.g., units, pieces, and m<sup>2</sup>) and budgetary terms. Chen and Danw (2004) expressed that most past investigations concentrated on operational productivity and viability, which straightforwardly impact the development of an organization. According to Wiklundet (2003) the smaller firms, the informal relationship between employees are essential. The researchers quote that, when the company's growth increases, it will result in a decrease in labour productivity. Furthermore, Rogers (2004) explained that the when bigger companies applies inflexible labour relations than this may contribute to reduction of labour productivity; so in other words, it does not mean that when there is growth, it will increase the labour productivity. As expressed by Greiner (1972) the impacts of development in labour profitability might be in a positive or negative frame.

### **Cash flow Management**

Cash flow management is the main contributing factor on short and long-term existence of a company (Munusamy, 2010); and cash flow statements need to be reviewed consistently (Statt and Truman, 2003). As stated by Aminu, (2012) managing cash flow includes payment of cash, collection of debt and current asset management, to disposal and buying of assets, up to making profitable investments. Surridge and Gillespie (2008) explained that in order for the SMEs to grow it has to identify the weaknesses on cash flow and how to manage the effectively to increase the company's cash composition. Minnery (2006) commented that if the company manages the cash flow effectively it will generate profit and eventually to the growth of SMEs. Buus and Tomas (2015), studied the risk-enhanced cash flow theory can explain both the observations, which support pecking order theory, free cash flow theory and trade-off theory of capital structure. It fits some evidence, which resists these theories: highly leveraged low growth companies and moderately leveraged large profitable companies.

### Hypothesis

- H1a: There is a negative relationship between working capital management with ROCE of SMEs.
- H1b: There is a negative relationship between working capital management with sales growth of SMEs.
- H2a: There is a positive relationship between asset management with ROCE of SMEs.
- H2b: There is a positive relationship between asset management with sales growth of SMEs.
- H3a: There is a positive relationship between productivity with ROCE of SMEs.
- H3b: There is a positive relationship between productivity with sales growth of SMEs.
- H4a: There is a positive relationship between cash flow management with ROCE of SMEs.
- H4b: There is a positive relationship between cash flow management with sales growth of SMEs.

### Methodology

The population of this study comprised of SMEs that are based in Malaysia between 2014 to 2018. The samples came from 256 private limited companies registered under the SME Corp website over the 5 year period and includes the account of descriptive analysis, diagnostic checking and regression analysis by using E-views 9. The sample is taken from the SME Corp website and the financial information will be obtained from the Commission of Companies in Malaysia (CCM). There are about 5180 SMEs classified under private limited companies and are registered on the SME Corp website. Companies are chosen from the manufacturing sector which represents chemical or physical transformation of components or materials into new products, services sector which include all services including hotels and restaurants; distributive trade; private education and health; professional and ICT services; entertainment and manufacturing-related services such as R&D, warehouse etc, while others sectors indicate primary agriculture which includes livestock, cash crops and perennial crops, forestry and logging, aquaculture and marine fishing, construction which constitutes special trade, residential and non-residential and infrastructure and mining and quarrying. The variables used in the study include independent variables namely; working capital management, which is measured by receivable collection period, asset management which is measured by total asset turnover, productivity management which is measured by labour cost competitiveness and cash flow management which is measured by free cash flow. The dependent variable is measured by ROCE and sales growth.

**Table 1: The Measurement of Variables**

	<b>Variables</b>	<b>Scale of measurement</b>	<b>Sources</b>
<b>Growth performance</b>	Sales growth	(Current sales-last year sales) / last year sales*100	Asif Iqbal& Wang Zhuquan (2014), Herri (2011), Samuel O., O., Victor T., O., & Wilfred, O. (2016).
<b>ROCE</b>	Return on Capital Employed	(Earnings Before Interest and Tax (EBIT)) / Capital Employed (Profit after Tax + Reserve + Long	Srinivas Kumar (2015) John F Darrymple (2004)&Robinson (2011)



		term Debt + Share Capital) Liabilities)*100	
<b>Working Capital Management</b>	Receivable collection period	Accounts receivables/ (sales) * 365 days	Tweneboah Senzu, Emmanuel and Ndebugri, Haruna (2017), Igwebuike, Agbo. (2018), Bazley <i>et al.</i> , 2004; Birt <i>et al.</i> , 2005;
<b>Asset Management</b>	Total asset turnover	Net Sales/ Total Average Assets	Nurlaela, Siti & Mursito, Bambang & Kustiyah, Eny & Istiqomah, Istiqomah & Hartono, Sri. (2019)
<b>Productivity Management</b>	Value Added Labour cost	Value added*/ **Labour Cost  * Sale-changes in inventory level +closing stock-purchase of goods and services Or Staff cost and other benefits +depreciation +interest +tax +profit before tax-non operating income+ non-operating expenses. **Labour Cost = Wages and salaries, commissions, bonuses, allowances, benefits and employers' contribution to CPF and pension funds.	Productivity measurement – SPRING Singapore (2011)
<b>Cash flow Management</b>	Free cash flow	Cash flow provided by operating activities – Capital expenditure	Buus, Tomás. (2015)., Figelwicz and Zeller, 1991; Mills, <i>et al.</i> , 1998; Schmidgall, <i>et al.</i> , 1993

## The Findings

Below are the findings from the analysis conducted using E-view for model 1 (sales growth) and model 2 (ROCE)

**Table 2: Analysis conducted using E-view for model 1 (sales growth) and model 2 (ROCE)**

	<b>Model 1 Sales Growth</b>	<b>Model 2 ROCE</b>
<b>Working Capital Management (WCM) (Receivable Period)</b>	-0.005***	1.770
	(0.0001)	(2.210)
<b>Asset Management (AM) (Total Asset Turnover)</b>	-0.857	-0.0006**
	(0.232)	(0.003)
<b>Cash flow Management (CFM) (Free Cash Flow)</b>	-2.280	1.110
	(2.100)	(1.290)
<b>Productivity Management (PM) (Value Added Labour Competitiveness)</b>	0.132*	0.0009***
	(0.098)	(0.0008)
<b>R-squared</b>	0.283	0.054
<b>Adjusted R –squared</b>	0.091	0.043
<b>Poolability Statistic</b>	298.004**	852.966***
<b>Breusch-Pagan Lagrange Multiple Statistic</b>	629.755***	33.924***
<b>Hausman Statistic</b>	38.882***	15.946
<b>Durbin-Watson Statistic</b>	1.688	1.866

### Working capital management

In Model 1, the working capital management (WCM) and sales growth shows a negative coefficient of -0.0005. This demonstrates that the growth in the working capital management of the firm will lead to decrease of the sales increase. As an example, sales growth will diminish by 0.0005% if there is a 1 % growth in the making for capital management, ceteris paribus. At the same time, the outcome indicates a coefficient of 1.770 in Model 2. There will an increment of 1.770% in ROCE if there is a 1 % increase in working capital management, ceteris paribus. From the findings, it shows that working capital management has a significant negative relationship with sales growth and an insignificant positive relationship with ROCE.

### Asset management

Asset management and sales growth shows a negative correlation with the coefficient of -0.857 in the Model 1. This indicates that the sales growth will decrease following by increase of asset management. Passed on that when the asset management, increased by 1% will lead to 0.857% reduction in sales growth, ceteris paribus. While, in Model 2, there is a positive coefficient of 0.0006. From the result, it reported that the increase in the asset management within the firm

will cause the ROCE to decline. As an instance, the ROCE will increase by 0.0006% if there is a 1 % gain in asset management, ceteris paribus. From the findings, it shows that asset management has an insignificant negative relationship with sales growth and a significant negative relationship with ROCE.

### Cash flow management

Cash flow management and the sales growth have a negative correlation from the result for Model 1. The coefficient of the cash flow management is -2.280. This entails that the cash flow management will not affect sales growth. Given that, the sales development will decrease by 2.280% if there is a 1 % increase in cash flow management, ceteris paribus. In this case, the assumptions cannot be applied since the result show insignificant correlation between cash flow management and sales growth. Nevertheless, in that respect is a positive significant correlation coefficient of 1.110 in Model 2. Thus, the ROCE will rise by 1.110% if there is a 1% increase in the cash flow management, ceteris paribus. From the findings, there is a insignificant relationship between cash flow management with sales growth and an insignificant positive with ROCE.

### Productivity management

There is a positive relationship found between productivity management and sales growth in the Model 1. The coefficient given is 0.132. This suggests that as the productivity management increase, the sales growth will increase. As an example, a 1 % increase in productivity, management of a company, the sales growth will be increased by 0.132%, ceteris paribus. The coefficient of the productivity management in the Model 2 is 0.0009. This indicates that when there is a gain in productivity management, the ROCE increases. Taken place on that productivity management increase by 1%, the ROCE will increase by 0.0009%, ceteris paribus. From the findings, there is a significant positive relationship between productivity management with sales growth and a strong positive relationship with ROCE.

**Table 3: Summary of hypotheses**

Hypotheses of the study	Decision	Regression Result (Probability)
H1a: There is a negative relationship between working capital management with ROCE of SMEs.	<i>Reject</i>	1.770 (0.2210)
H1b: There is a negative relationship between working capital management with sales growth of SMEs.	<i>Accept</i>	-0.500** (0.001)
H2a: There is a positive relationship between asset management with ROCE of SMEs.	<i>Reject</i>	-0.0006** (0.002)
H2b: There is a positive relationship between asset management with sales growth of SMEs.	<i>Reject</i>	-0.857 (0.2320)
H3a: There is a positive relationship between productivity with ROCE of SMEs.	<i>Accept</i>	0.0009*** (0.0008)



H3b: There is a positive relationship between productivity with sales growth of SMEs.	<i>Accept</i>	0.132* (0.098)
H4a: There is a positive relationship between cash flow management with ROCE of SMEs.	<i>Reject</i>	1.110 (2.290)
H4b: There is a positive relationship between cash flow management with sales growth of SMEs.	<i>Reject</i>	-2.280 (2.100)

### Conclusion

This chapter revealed the relationship between sales growth and performance (ROCE) of SMEs with the independent variables (working capital management, asset management, productivity management and cash flow management), of private limited SMEs in Malaysia. The main purpose of this research is to investigate the impact of working capital management, asset management, productivity management and cash flow management on growth performance of SMEs in Malaysia. The total 256 private limited companies which are listed under the SME Corp were taken into account in this research from the period of year 2014 to the year 2018. Test statistic result in Model 1 shows that productivity management and working capital management has a significant influence towards sales growth. While in Model 2, there is a significant relationship between productivity management and asset management towards ROCE.

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