

THE DETERMINANTS AFFECTING THE GROWTH PERFORMANCE BASED ON SECTORS OF SMALL AND MEDIUM SIZED 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 growth performance is linked with financial management variables, but very limited studies have been conducted on sales growth, ROCE, working capital management, asset management, production management, cash flow management, profitability and corporate governance based on sectors and states of SMEs in Malaysia. This study examined the factors that influence the growth performance of SMEs in Malaysia, especially for non-listed private limited SMEs 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) cash flow management (free cash flow), profitability (net profit), corporate governance (directors' remuneration) and with the sectors and states of SMEs in Malaysia. 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.*

Keywords: *Sales Growth, ROCE, Working Capital Management, Profitability and Cash Flow Management*

Introduction

A company's achievement can be measured using internal growth. Most authors quantify that a strong growth company has a better success and survival rate compared to less successful firms (Roper, 1999; Bergström, 2000). Based on the growth Model of Churchill & Lewis (1983) a newly established company may be able to grow drastically. Even though growth may not exist immediately, but by investing in the business it will have a greater effect in the future. So in other words, the investing elements are essential for new establishments to stay alive. According to the model, younger companies are less experienced and organisationally inefficient. According to Phillips & Kirchhoff (1989), if a young company does not grow or have insignificant growth, then the rate of survival will be very slim. The company's growth will be strong and healthy if it adds value to the company's internal system. When the company grows, it will lead to an increase of workforce in the country.

Company directors have a responsibility to make sure that the company takes note of the determinants that will improve growth performance. The financial ratio analysis for performance evaluation has been clearly explained by Gopinathan Thachapillay (2009). Financial ratio analysis is used to gain a sense of the monumental quantity of numbers represented in company financial statements. It helps the investors to identify whether the company has a good financial performance which will allow them to make the decision to invest in that company. This survey will concentrate mainly on firm specific determinants which include working capital management, productivity management, asset management and cash flow management.

Literature Gap

Firstly, most of the research conducted on SME development is based on profitability and firm performance but not on SME growth performance. Yasir, Majid & Yousaf (2014), Charitou, Lois and Halim (2012), Pedro J. Garcia – Teruel (2007) and Abdullah Hassan Gorondutse (2016) used accounts receivable period, stock turnover, return on assets (ROA), net operating profit (NOP), cash conversion cycle to measure profitability rather than measuring growth performance. Secondly, there has been fewer research done on the impact of productivity management with growth performance of SMEs in Malaysia which is the main contribution of this study. S.N. Rajesh Raj, Mihir K. Mahapatra (2009) studied on the total factor productivity growth, and the development of employment and investment, between growth and labour productivity in small and medium-sized Portuguese. Thirdly, most research conducted is based on public listed companies and not on private limited companies. Zainudin (2008), Divesh S. Sharma (2005), Georgeta Vintila & Elena Alexandra Nenu (2016), Nurul Badriyah, Ria Nelly Sari & Yesi Mutia Basri (2015) studied on public listed companies in Malaysia, companies from Singapore Stock Exchange, Bucharest Stock Exchange and Indonesia Stock Exchange. Fourthly, most of the research conducted mainly focused on manufacturing, construction and service sector SMEs. Abdullah Hassan Gorondutse (2016), Al-Mawshaki Randa Mohammed & Shams Addin (2014), Mohd Suberi Ab. Halim, Mastura Jaafar, Omar Osman, Md. Shariff Haniff (2012), Muhammad Yassir (2014) and Kuen-Hung Tsai, Hooy (2009) focused on manufacturing, construction, technology, cement, wholesale & retail, restaurant, investment business service companies in Malaysia, while Hooy (2009) focused on SMEs mainly on Kedah and Perak, in the northern part of 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. A positive link has been established between working capital management and profitability of the larger manufacturing companies, for examples Chatterjee (2010), Davis (2016), De-Almeida and Eid (2014) and Hussain *et al.* (2012) highlighted a positive significant relationship between working capital management and profitability in relation to the manufacturing sectors. 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.

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.

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 m²) 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 when bigger companies apply 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. As reported by Brigham and Ehrhardt (2013), free cash flow is the excessive cash obtained to be used as spend on company business expansions. Non-optimal activities are preferably undertaken by managers with large amount of free cash flow as stated by Jensen (1986). The highest level of debt will make the value of the company become higher when the operating cash flow of the organisation is more than its profitable investment opportunities.

Corporate Governance

The effect of directors' remuneration on performance has been documented by previous research (Main *et al.*, 1996; Brick *et al.*, 2006). High compensation packages may impair the directors' judgement, giving managers the advantage of being able to pursue their own interests at the expense of performance. A negative relationship between directors' remuneration and firm growth performance was documented by Ozkan (2007). According to Godfred Afrifa (2015), corporate governance factors (board size, CEO age and tenure, and directors' remuneration) have a significant impact on the performance of UK listed SMEs. These findings are consistent with previous research in respect of board size (Yermack, 1996; Vafeas, 1999), CEO age (Yim, 2013), CEO tenure (Agrawal and Knoeber, 1996) and directors' remuneration (Ozkan, 2007).

Profitability

According to Cox, Camp and Ensley (2002) there is a strong relation between sales growth and profitability growth. According to Vijayakumar (2011), the study concluded that the firms' industry is significantly associated with profitability. The study by Salman and Yazdanfar (2012) indicates that firm industry affiliation have a positive effect to the profitability. Cowling (2004) investigated UK firms and found that profit and growth positively relate to each other. In a research conducted by Roper (1999), establish that sales growth and ROA are weak. Furthermore, Sexton, Pricer and Nenide (2000), who tested over 75 000 firms in the Kauffman Longitudinal Financial Statement Database, happen to discover a very weak relation to sales growth and profitability. It is consistently related to higher financial performance and growth based on the studies conducted by Capon, Farley and Hoening (1996).

Sector

Sector refers to groups of SME enterprises regarded as having certain features in common (Macmillan Education, 2002). Karimi (1998) points out that enterprise category consists trading (54%), manufacturing (23%), service (15%), and wholesaling (8%). Perren (1999) stratifies the

16 SME enterprises offering accountancy services into manufacturers, retailers, wholesalers, and service providers. It has arguably become difficult to put a single category description because SME enterprises mix several kinds of work depending on demand (King, 1996). According to Teng Hou Loi & Arslan Aslam Khan (2012) companies in the service sector has a strong relation to the growth of a firm. In other words, firms in service sector will have better growth compared to manufacturing or distribution sector. the manufacturing sector is represented by chemical or physical transformation of components or materials into new products, meanwhile the services sector is represented by 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, and others sector is represented by primary agriculture which includes livestock, cash crops and perennial crops, forestry & logging, aquaculture and marine fishing, construction which constitutes special trade, Residential & non-residential and infrastructure and mining & quarrying (SME Corp).

Theoretical Review

Agency Theory

Agency theory can be seen as an agreement between resource holders. An agency relationship occurs when the principals engage the agents to delegate or perform tasks on the behalf of the principle. The primary agency relationships in business are those (1) between shareholders and managers and (2) between debtors and shareholders. These relationships will have a conflict of interest between agents and principles because both parties may not have the similar interest in the wealth of the company. Corporate governance and business ethics has implications between agents and principles. In order to sustain an effective agency relationship, it increases the agency costs, for example to encourage managers to act in the shareholders' interest, the management has to offer performance bonuses to its managers. To summarise with, the agency theory has become the most important model in the literature of financial economics.

Measuring the Variables used in this Study

The variables used in the study include variables such as growth performance which is measured by sales growth and ROCE; working capital management which is measured by receivable collection period; asset management which is measured by total assets turnover; productivity management which is measured by labour cost competitiveness and cash flow management which is measured by free cash flow, corporate governance which is measured by directors' remuneration and profitability which is measured by net profit ratio.

Table 1: The Measurement of Variables

	Variables	Scale of measurement	Sources
Growth performance	Sales growth	(Current sales-last year sales) / last year sales*100	Asif Iqbal& Wang Zhuquan (2014), Herri (2011), Firth, Fung and Rui (2006), Brown and Caylor (2004) John F Darrymple (2004)

ROCE	Return on Capital Employed	(Earnings Before Interest and Tax (EBIT)) / Capital Employed (Profit after Tax + Reserve + Long term Debt + Share Capital) Liabilities)*100	Srinivas Kumar (2015) John F Darrymple (2004)&Robinson (2011) Uadiale (2010), Filatotchev, Lien and Piesse (2005)
Working Capital Management	Receivable collection period	Accounts receivables/ (sales) * 365 days	Bazley <i>et al.</i> , (2004); Birt <i>et al.</i> , (2005); Hilton, 1994; Jackling <i>et al.</i> , (2004); Peacock <i>et al.</i> , (2003)
Asset Management	Total asset turnover	Net Sales/ Total Average Assets	John Bajkowski (1993)
Productivity Management	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)
Cash flow Management	Free cash flow	Cash flow provided by operating activities – Capital expenditure	igelwicz and Zeller, (1991); Mills, <i>et al.</i> , (1998); Schmidgall, <i>et al.</i> , (1993)
Corporate Governance	Directors' Remuneration	The amount of directors' remuneration from the financial statement	Main <i>et al.</i> , 1996; Brick <i>et al.</i> , 2006), Godfred Afrifa (2015), Yim, (2013)
Profitability	Net Profit	Earnings after tax/net sales * 100%	Frank wood (2015)

Methodology

SMEs samples of 256 companies will be taken from the SME Corp website and based on the private limited companies registered in SME Corp website; the financial statements will be obtained from Commission of Companies in Malaysia (CCM) from the year 2014 to 2018. The samples of 256 companies are calculated by taking 5% on the total of 5180 SMEs of private limited companies registered in the SME Corp. Random sampling is used for this study. Companies are chosen from 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 sector indicate primary agriculture which includes livestock, cash crops and perennial crops, forestry & logging, aquaculture and marine fishing, construction which constitutes special trade, Residential & non-residential and infrastructure and mining & quarrying. The company names are chosen randomly from the SME Corp directory and subsequently the chosen company names will be matched and searched in the CCM website in order to verify whether the companies are still operational or not. After the verification has been made, then only their financial statements for the year 2014 to 2018 will be retrieved and the data will be used for this research.

The Findings

Table 2: Contribution based on Sectors

Variables	Manufacturing (Coefficient)	Trading (Coefficient)	Service (Coefficient)
Sales Growth	0.11	0.38***	0.34***
ROCE	0.97***	0.60***	0.65***
Working Capital Management	176***	354***	285**
Cash Flow Management	599852.8***	471961.9***	33209.2***
Asset Management	19077.12	7.28**	2.51**
Productivity Management	-1.94	6.88***	4.62***
Profitability	-419.40	7.76***	-52.43
Corporate Governance	12254.4***	99122.67***	157590.9***

Notes: * Significant level at 10%, ** Significant level at 5%, *** Significant level at 1%

Based on the result above, the SMEs from trading sector generate the highest sales growth (0.38%), meanwhile the SMEs in manufacturing sector generates the lowest sale growth (0.11%). This means that the trading sector has the highest sales compared to the manufacturing and service sectors; the SMEs in manufacturing sector generates the highest ROCE (0.97%), meanwhile the SMEs in service sector generates the lowest ROCE (0.60%); the SMEs in manufacturing sector has the shortest receivable collection period (WCM) which is 176 days, meanwhile the SMEs in trading sector has the longest receivable collection period (WCM) which is 354 days. This means that the manufacturing sector is able to collect their debts faster

compared to the trading sector; the SMEs in manufacturing sector has the highest free cash flow (CFM) which is RM599852.80, meanwhile the SMEs in service sector has the lowest free cash flow (CFM) which is RM33209.20. The reason that the manufacturing sector has the highest free cash flow is due to the shortest collection period policy which enable them to collect cash from the debtors faster compared to other sectors; the SMEs in manufacturing sector generates the highest total asset turnover (AM) of 19077.12 times, meanwhile the SMEs in service sector generates total turnover assets (AM) of 2.51 times. This means that the manufacturing sector manage their assets effectively; the SMEs in trading sectors has the highest labour cost competitiveness (PM) of 6.88 times, meanwhile the SMEs in manufacturing sector that generates the lowest labour cost competitiveness (PM) of -1.94 times; the SMEs in trading sector generates 7.71 of profit ratio (PR), meanwhile the SMEs in the manufacturing sector generates the lowest profit ratio (PR) of -419.4. The trading sector enjoyed the highest profitability due to the highest sales growth compared to the other sectors. Lastly, the SMEs in service sector pays the highest directors' remuneration (CG) of RM157590.90, meanwhile the SMEs in manufacturing sector pays the lowest directors' remuneration (CG) of RM157590.

Location (States)

Table 3: Contribution based on States in Malaysia

STATES	SG	ROCE	WCM	AM	PM	CFM	CG	PR
JOHOR	3.02	0.83***	15***	2.83***	2.29***	682028***	205346***	17.6
KEDAH	1.12	0.76***	46***	4.30	4.30***	574210***	96592***	-0.92***
KELANTAN	1.16*	0.45***	70***	1.74***	2.13***	-13762	50972***	-12.6*
MELAKA	0.58***	0.30***	33***	2.77***	4.59***	227602***	92261***	-10.3***
NEGERI SEMBILAN	15.5	0.61***	91***	1.18***	7.63***	40892	102504***	-307**
PAHANG	19.2	0.32***	157***	1.38***	5.34	688655**	121353***	-30.7
PENANG	9.41	0.50***	288	2.33***	5.55**	163820***	131028***	34.6***
PERAK	0.58	0.17	284***	7.22***	-12.4	227836***	182980***	29.3***
PERLIS	1.14	0.49***	168***	1.97***	3.01***	125973	93171***	-14.1
SABAH	1.47	0.71***	261***	1.66***	2.05***	428954**	217054***	-41.2***
SARAWAK	2.55	0.86***	233**	2.15***	-0.26	1108916***	80016***	-80.9*
SELANGOR	21.3	1.16***	114***	6.13***	7.45***	312053***	116674***	23.3
TERENGGANU	1.01*	0.53***	226***	1.40***	0.49*	49952	134989***	-1146.7
WILAYAH PERSEKUTUAN	18.5	0.65***	345**	1.78***	5.68***	603829***	217725***	-104.6

Notes: * Significant level at 10%, ** Significant level at 5%, *** Significant level at 1%

SG = Sales Growth, ROCE = Return on Capital Employed, WCM = Working Capital Management, AM = Asset Management, PM = Productivity Management, CFM = Cash Flow Management, CG = Corporate Governance, PR = Profitability

Based on the results above, the SMEs in Selangor generates the highest sales growth of 21.3%, meanwhile the SMEs in Melaka generates the lowest sales growth of 0.58%; the SMEs in Selangor generates the highest ROCE of 1.16%, meanwhile the SMEs in Sabah generates the lowest ROCE of 0.17%; the SMEs in Johor has the shortest receivable collection period (WCM) of 15 days, meanwhile the SMEs in Wilayah Persekutuan has the longest receivable collection period (WCM) of 345 days; the SMEs in Perak has the highest total asset turnover (AM) of 7.22 times, meanwhile the SMEs in Negeri Sembilan has the lowest total asset turnover (AM) of 1.18 times; the SMEs in Selangor generates the highest value added labour competitiveness cost (PM) of 7.45 times, meanwhile SMEs in Perak contributes the lowest value added labour competitiveness cost (PM) of -12.40 times; the SMEs in Pahang has the highest free cash flow (CFM) of RM688655, meanwhile the SMEs in Kelantan has the lowest free cash flow (CFM) of RM-13762; The SMEs in Wilayah Persekutuan pays the highest directors' remuneration (CG) of RM217725, meanwhile the SMEs in Kelantan pays the lowest directors' remuneration (CG) of RM50972; the SMEs in Selangor generates the highest profit ratio (Profitability) of 23.3, meanwhile SMEs in Terengganu generates the lowest profit ratio (Profitability) of -1146.7. Since the SMEs in Selangor has the highest sales growth, they are able to obtain the highest profitability compared to other states.

Conclusion

Based on the results above, the highest sales growth (21.3%) and profitability (23.3) is generated by SMEs in Selangor, Wilayah Persekutuan (18.5%) and Penang (9.41%) and this consistent with the statistics by department of statistic in Malaysia (DOSM), SMEs in Selangor recorded the highest growth of 10.8%, Penang with 10.0% and Johor at 9.3% of GDP growth in the year 2018. It also can be proved through the economic research report on the Sarawak state (2015), Selangor and Wilayah Persekutuan generate the highest economic growth by 22.2% and 13.9% respectively. According to the SME 2015/16 annual report Selangor has the highest number of SME established which contributes the highest sales growth and profit of SMEs in Malaysia compared to other states. Meanwhile the SMEs in manufacturing sector contributes the highest sales growth, Return on Capital Employed, cash flow management, asset management and the shortest receivable collection period compared to other sectors.

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