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Financial Management Practices: Challenges for SMEs in Malaysia

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Abstract
Organizational performance is one of the most important constructs in management research. Different organizations use different performance measures. Several studies show that financial management practices are highly relevant to the performance of a firm or organization. Previous studies have found significant differences in management practices among organizations and countries, and these practices are closely linked to organizational innovation and other performance indicators including profitability rates and survival. From that, this study aims to identify the challenges and obstacles faced by SMEs in Malaysia in terms of financial management practices in influencing organizational performance. Thus, financial management practices are an important aspect in contributing to business development and at the same time can help an organization to compete in the business world.
Keywords: Entrepreneurship, Financial Management, Financial Management Practices, Organizational Performance.

Introduction

Small and medium enterprises (SMEs) are a very large sector of our economy in terms of the number of entities that fit into a category. A healthy SME sector will definitely be something good for Malaysia in a challenging economic environment in which the product life cycle is shorter and competition can come from any angle, domestically or abroad (Lim & Teoh, 2021; The Edge, 2014). One of the prime movers in maintaining a business to continue to grow is the quality of financial management as practiced in the economic entity. Financial management is one of the most important functions in the organization. Financial accounting, planning, evaluating financial ratios and financial strategy development occurs in every organization. Financial management is the duty of the director of the organization and financial expert, but knowledge of the issues and financial procedures will help any employee to do their job better and to understand the conflicts that often arise between financial officers and other departments. Most SMEs do not appoint a financial manager to be responsible for the financial management of the company. The manager who does not have formal training in handling management skills, particularly financial management usually will be assisted by the chief accountant of the company in dealing with matters related to finance. At present, financial management is one of the challenges of SMEs. While managers have a high level of education or have higher financial knowledge, it does not necessarily translate to better financial management unless they have deep experience in financial management (Jangkholam, 2021).

Amoako (2013) review in Aryeetey et al (1994) study had claimed that there are practical issues in obtaining the records and data that make up the statements when evaluating the financial management practices by small and medium firms. The lack of records for all types of sales, marketing, accounting, credit borrowing from lending institutions, staff costs, owners' emoluments, etc. is due in part to the fact that the owners of practically all businesses store all the records in memory. Owners of SMEs do not keep proper records and thus, they are not able to provide data about their entities. If this thing continues happening on entrepreneurs, how they will be successful? Do they have to make changes to the financial management practices? Or is it because they lack skills in financial management makes them less confident to get finance from financial institutions? This question has prompted researchers to be more interested in reviewing the financial management practices among entrepreneurs in Malaysia. Furthermore, previous study by Yusoff (2010) had stated that, the issue of whether adequate financing is made available to the SME sector is a never-ending one. The reasons are very simple. First, the number of entities in the sector will continue to grow, and any amount of financing will not be enough. Second, chances are the group that may have difficulties in accessing funding from banks and other institutions would be those in the start-up stage or even at the fast-growth stage as these are the stages where the risks are the highest. Small and medium-sized businesses (SMEs) should bear the most responsibility by ensuring that efforts are made to improve financial management in their businesses. It's not uncommon for SMEs to fail to preserve accurate financial records. How do they convince financiers that they are deserving of funding while they are unsure of their company's financial position?

For example, due to a lack of experience in management, inefficiencies in the financial record system, and a lack of collateral, the SME's survival time was usually relatively short. Furthermore, the banks had deduced that a small business was vulnerable to external business risks such as market volatility and exchange rate variations. As a result, their financial records did not meet the bank's requirements, and they had more difficult access to funds. This was due to the fact that banks were selective in their lending and were not always able to provide loans to companies in need of capital. From that, the objectives of the study are as follows:

- To highlight the business performance among small and medium enterprises (SMEs) in Malaysia
- To identify the challenges of small and medium enterprises (SMEs) in Malaysia

Literature Review

SMEs Performance

Small and medium enterprises (SMEs) performance issues have drawn the interest of scholars from various disciplines and perspectives (Joensuu-Salo et al., 2018; Maes et al., 2005; Sadiq et al., 2020). Two performance measures are notable in the literature: financial measures, such as profit, turnover, return on investment, productivity (Saad and Patel, 2006; Maes et al., 2005; Shamsuddin et al., 2018) and non-financial measures, including the number of employees, communication, learning, trust, stakeholder satisfaction, and competitive position (Chang et al., 2021; Garrigos-Simon et al., 2005). However, Murphy et al (1996) discover that the most frequently used measures are predominantly economic. Factors associated with firm performance have also become the interest of many researchers (Robb & Watson, 2012). Rogoff et al (2004) argue that the success or performance of firms is determined by internal and external factors. Wijewardena and Tibbits (1999) in their literature survey found that firm performance is related to individual entrepreneurs, firm-specific attributes, and external factors. In relation to firm size, a large number of literatures have been generated in many disciplines, including economics, management and sociology to address the question whether larger firms enjoy higher performance than that of smaller firms (Majumdar, 1997). Cooper and Dunkelberg (1986) assert that small firms may have limited access to various human, financial and organizational resources which in turn retard their performance (Amaral et al., 2011; Ramzi et al., 2021).

Also, previous study by Cragg and King (1998) argue that financial performance of small businesses is strongly influenced by the markets where they operate as well as entrepreneur's objectives, characteristics and management practices (Islam et al., 2011; Ridzwan et al., 2021). Othman and Rosli (2011) in their literature survey found that marketing resources and capital structure mix of enterprises as well as previous experience, skill and educational level of the owners are factors influencing small business performance. All these factors are internal to the businesses. In reality, however, external factors or environments would influence small business performance. This external environment is beyond the control of a business and can be either hostile (Smallbone & Welter, 2001) or in favour of small businesses. External environments would come in many forms, such as macro-economic policies and procedures (Fogel & Zapalska, 2001), access to financing and infrastructure, quality of infrastructure services and time saved in obtaining licenses which may directly or indirectly impact small business performance (Sharma et al., 2007).

Challenges of SMEs in Malaysia

Recently, small and medium enterprises (SMEs) play an increasingly important role in the economic growth of most nations. SMEs have become important as a source of employment and maximize the efficiency of the resource allocation and distribution by mobilizing and utilizing local human and material resources (Cunningham & Rowley, 2007; Jia et al., 2020). Large companies use SMEs as a source of goods and services. The majority of SMEs have been described as dynamic, innovative, and efficient, and their small size provides for greater flexibility, immediate feedback, a shorter decision-making chain, and a better understanding of and response to client needs (Singh et al., 2008; Idar et al., 2012). In Malaysia, the last few decades also saw a tremendous increased in participation of SMEs which are seen to be playing a major role for the nation's economic development (Mahmood & Hanafi 2013; Osman & Ngah, 2016; Sumaiyah & Rosli, 2011). At the same time, as Malaysia becomes more integrated into the global economy, SMEs confront significant challenges. Globalization, technical innovation, demographic and sociological change, as well as the amount of technology deployed, innovative capacity, financial support, and entrepreneurship, all have an impact on the business environment as both external and internal elements (Mahmood & Hanafi, 2013; Osman & Ngah, 2016). In order to be able to seize the opportunities that this dynamic environment opens up, women owned SMEs have to refigure their existing strategies.

However, irrespective of country, SMEs face common problems in respect of their survival or to take competitive advantage. According to the available resources more than 50% of SMEs are collapse within first five years of operation (Khalique et al., 2011). In case of Malaysia there is no reliable figure published, so for the estimated failure rate of SMEs is approximately of 60% (Ahmad & Seet, 2009; Khalique et al., 2011). It reflects that SMEs in Malaysia are facing serious issues and plenty of obstacles to stay as competitive enterprises in market. Malaysia is now entering into a knowledge-based economy. The challenge of globalization has made it vital for Malaysia to move towards a knowledge-based economy (Bhatiasevi, 2010). In the preface of the Eight Malaysian Plan 2001-2005, Mahathir the former Malaysian Primer, said "during the Eight Malaysia Plan period, we will be faced with even greater challenges from globalization and liberalization as well as the rapid development of information and technology. We will have to shift the growth strategy from being input-driven towards one that is knowledge-driven" to achieve the vision 2020 of become a developed nation (Bhatiasevi, 2010; Khalique et al., 2011). In order to achieve vision 2020 and to be a fully developed and industrialized nation, the future progress seems to be mainly concentrated on the development of SMEs (Omar & Ismail, 2009).

It has long been acknowledged that SMEs contribute significantly to overall economic performance in Malaysia. However, the performance of SMEs still has not reached the stage of full potential. Although the number of SMEs hit more than 90% of the total establishments in most countries, including Malaysia, it does not show the strength of a company or industry. In fact, SMEs have been very fragile and more vulnerable to the external environment (NSDC, 2012). This was proven during the current global economic and financial crisis and the 2011 catastrophe in Australia, Japan, New Zealand and the United States (US); Malaysian SMEs also indirectly suffered the impact of the crisis through trade channels of lower export demand and the slowdown in capital flows that affect investment. As declared in the report on the annual survey of manufacturing industries, 2010, following the downturn from the global economic and financial crisis in 2009, SMEs in the manufacturing sector registered a negative growth of 5.6%, which was in line with the overall performance of the manufacturing sector, which recorded a negative growth of 10.7%. The SME value added also showed a decrease of RM1, 735 million from RM 35,457 million in 2008 to RM 33, 722 million in 2009. This indicates that the decline of SMEs growth is very drastic, compared to four years back, where SMEs showed an increase in healthy growth in 2005 (3.2%), 2006 (7.2%), 2007 (11.8%), and 2008 (12%) as illustrated in Figure 2.1 (DOSM, 2011).

Figure 2.1: Contribution of SMEs Output and Value Added to the Manufacturing Sector, 2005-2009
Source: DOSM (2011)

However, in 2020, the growth of SMEs' GDP registered at negative 7.3 percent, which was lower than Malaysia's GDP for the first time over the past 17 years since 2003 (Figure 2.2). The contribution of SMEs GDP eased to 38.2 per cent in 2020 with a value added of RM512.8 billion as against 38.9 per cent (value added: RM553.5 billion) in the preceding year (Figure 2.3). Services and Manufacturing sectors remained as the main drivers of SMEs GDP activities which both sectors represent more than 80 per cent to SMEs GDP. SMEs value added for services sector decreased 9.2 per cent in 2020 from 7.5 per cent in the preceding year. The sluggish momentum was due to the decline in wholesale & retail trade, food & beverages and accommodation sub-sector which posted a negative growth at 7.8 per cent (2019: 7.7%). Finance, insurance, real estate and business services sub-sector also recorded a decrease in 2020 to negative 10.6 per cent (2019: 7.8%). Concurrently, Transportation & storage and information & communication sub-sector was affected by the pandemic COVID-19, contracted 11.4 per cent (2019: 6.6%) especially on land transport activity. Meanwhile, Information & communication activity remained positive in 2020.

Furthermore, SMEs in Construction sector decreased 15.4 per cent as compared to 0.3 per cent in the previous year due to the decline in all sub-sectors. For Manufacturing sector, value added of SMEs registered a negative growth of 2.9 per cent, dropped from 4.5 per cent in 2019. The decline was attributed by Non metallic mineral products, basic metal and fabricated metal products which plummeted 13.1 per cent (2019: 4.9%). In the meantime, Petroleum, chemical, rubber and plastic products continued recording a positive growth at 3.2 per cent (2019: 4.3%). This was followed by Food, beverages and tobacco products which remained positive growth at 2.0 per cent (2019: 3.2%). Meanwhile, value added of SMEs in Mining & quarrying sector narrowed to 7.1 per cent from 19.5 per cent in 2019. Similarly, in Agriculture sector, value added of SMEs decreased to 0.3 per cent (2019: 2.3%). The decrease was attributed to the decline in all sub-sectors except for Livestock and Other agriculture which continued with a positive growth as illustrated in Figure 2.2 below (DOSM, 2021).

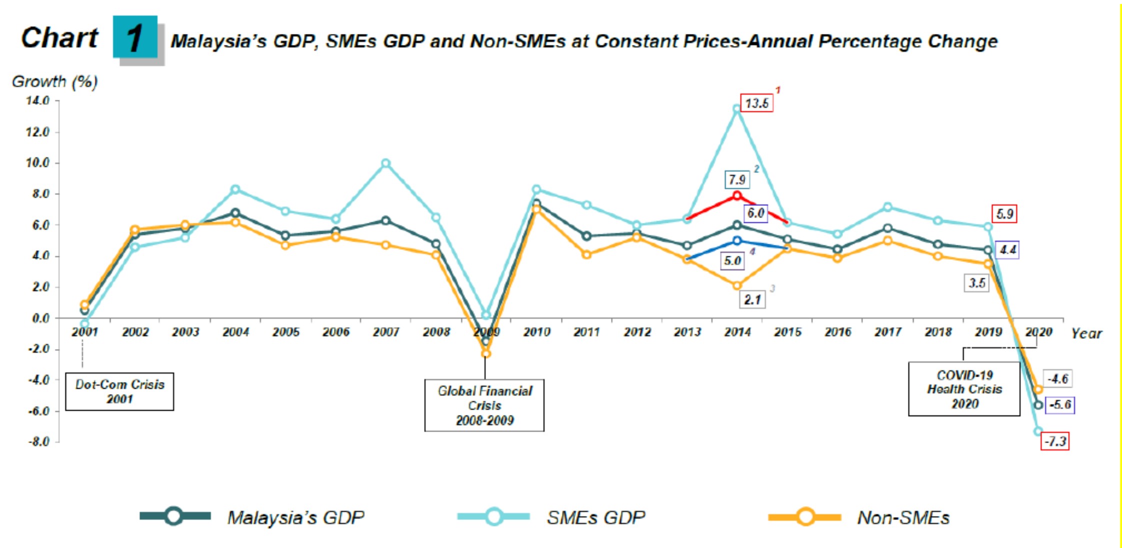

Figure 2.2: Malaysia's GDP, SMEs GDP and Non-SMEs at Constant Prices-Annual Percentage Change
Source: DOSM (2021)

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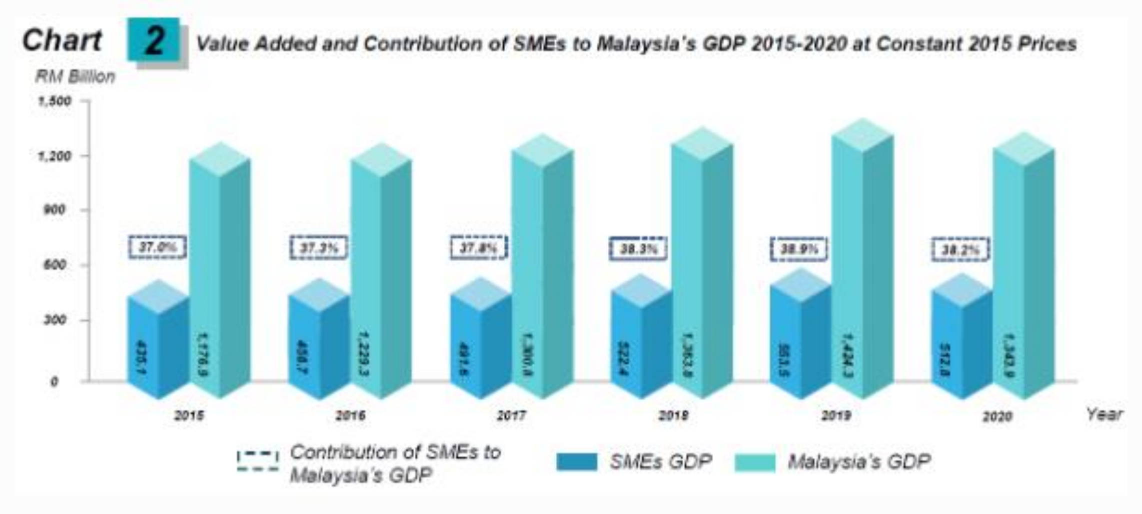

Figure 2.3: Value Added and Contribution of SMEs to Malaysia’s GDP 2015-2020 at Constant 2015 Prices
Source: DOSM (2021)

In addition, the literature also found that the failure rate of SMEs is extremely high. Firms may fail at different stages. Some of the firms fail in their early stages while others fail after a few years of their establishment (Ladzani & Van Vuuren, 2002). For instance, a study by USA Small Business Administration noted that some 25% of small enterprises fail within two years, and 63% fail within six years. It was also reported that this similar rate of failure occurred in the UK, the Netherlands, Ireland, Japan, and Hong Kong. Meanwhile, Shepherd and Wiklund (2009) also disclosed that almost 50% of new firms survive up to six years and then die off (Rahim et al., 2015). Similarly, in Malaysia, a report from Portal Komuniti KTAK, 2006, has revealed that the failure rate among SMEs was as high as 60% (Ahmad & Seet, 2009), and this figure is considered quite alarming (Jamaludin & Hasun, 2007; Rahim, Mohtar & Ramli, 2015). To improve the performance, the SMEs need to realize their full potential and seize any opportunities to upgrade them to become more competitive. To remain competitive, SMEs have to shift towards higher value-added activities, and adopt best industry business practices that will help them to prepare and recover from natural disasters, where SMEs are particularly vulnerable. This is in line with the theme of "Transformation to the New Economic Model", which has enormous implications for SMEs (NSDC, 2010; Rahim et al., 2015). SMEs need to change their mindset to transform themselves to support the Malaysian strategies to become a high-income, developed country starting in 2020. This transformation requires SMEs to develop their organizational resources and capabilities that will move them to become more competitive, innovative, and with a technologically strong SME sector. These organizational resources and capabilities are more devoted to realize high performance and high value-added SMEs, which are equipped with strong technical and innovation capabilities as well as personal and business skills to comprehend new job opportunities, and better market access (Nazlina, 2013).

Discussion and Conclusions

In today's worldwide environment, SMEs face a variety of obstacles. Small businesses should concentrate their efforts on overcoming obstacles such as the recession, barriers posed by global sourcing, low productivity, a lack of managerial capabilities, a lack of capital, difficulty in gaining access to management, technology, and a large regulatory load. These include lack of adequate working capital, poor management skill and inadequate use of essential business and management practices. The use of financial management practices which can provide crucial information to the management is vital to ensure the effectiveness and efficiency of the business. Thus, finance has been identified in many business surveys as the most important factor determining the survival and growth of small and medium–sized enterprises in both developing and developed countries. At the same time, access to finance is the ease with which SMEs can get finance to undertake productive investments to expand their businesses and to acquire the latest technologies, thus ensuring their competitiveness.

Accordingly, this study wants to highlight the business performance and also wants to identify the challenges of small and medium enterprises (SMEs) especially in Malaysia. Based on the contribution of this study, it emphasizes the importance of financial management practices where the ability of SMEs in managing business finances can help them to improve their business performance. This study is expected to be able to give awareness among entrepreneurs, where they can learn the proper way of financial management and know the suitable channels in obtaining business financial resources. The government and non-governmental organizations are also expected to be able to provide appropriate training to SMEs which can help them to prepare the company's finances in a good way. The ongoing changes in organizations today have implications for the conceptualization and research efforts of business performance. More specifically, future performance-related research must pay more attention to the issue of financial management practices and how to prepare a financial statement among SMEs. Therefore, further theoretical development regarding to the business performance of SMEs is very necessary in ensuring the sustainability of SMEs in Malaysia.

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