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THEMATIC

In this report:

Malaysia – Need for effective measures to support SMEs

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Malaysia: Need for effective measures to support SMEs

The unprecedented impact from the Covid-19 pandemic is seen hurting the global economy on two aspects i.e. supply and demand. It has induced global recession including Malaysia. We have reduced the 2020 global GDP to 0.8% from previously 2.8% and Malaysia's growth to 0.4% with the downside at -2.0, from previously 3.0%. Our SMEs growth for 2020 is 1.9% with the downside at -0.5% from previously 6.0%.

With the growth downgrade comes a loss in revenue – at the national level between RM58bil and RM92bil from our initial projection of 4.5% GDP for 2020 while for SMEs is between RM23bil and RM36 billion based on the initial growth of 6.0%. Thus, it reduces average per day revenue to RM0.03 billion based on a 1.9% SME growth from RM0.09 billion previously at 6.0% growth. The risk for SMEs' average per day earnings to shrink cannot be ruled out, estimated at -RM0.01 billion at -0.5% growth.

Even if the movement control order (MCO) is lifted by mid-April or end April, demand is expected to be weak for some time due to travel aversion and social distancing. Many SME businesses have been forced to close their doors, and some may not reopen. Apart from revenue loss, they will be impacted by poor credit standings. The drop in consumer and corporate spending will intensify the adverse chain reaction that will fuel the collapse of micro businesses, especially the younger and smaller businesses due to their highly vulnerable situation. Generally, the older and larger small businesses are more likely to withstand an economic crisis. Exports will stay weak from lockdowns. Commodity prices will be soft. Bankruptcies and bad loans are concerning factors. Job losses are also a concern although these are expected to vary considerably according to the age and size of the small businesses.

Meanwhile, not every small business is equipped to survive this downturn. And because small businesses contribute disproportionately to job loss during recessions, policy responses are necessary. In our current crisis, these measures must occur immediately — which means that speed and simplicity are important considerations. If speed and simplicity are required in the short term, then "scale" is the operative word for the medium-term recovery.

In the long term, policymakers and business development providers should remember that the 2008 global financial crisis (GFC) was being distinctly damaging to SMEs. And that was at a time when shops and restaurants could still rely on social interaction and foot traffic for business. Covid-19 has stripped even that advantage away. This crisis will demand a set of policy support measures that are both broader and longer term than those pursued in 2009. Otherwise, small businesses are certain to face a calamity.

Thus, measures should look into post coronavirus rebuilding of the economy. There must be a single government-backed public-private partnership agency tasked to rebuild the SME economy. Hence, it will be vital to look back at what happened to SMEs during the 2008 GFC and probably as far back as the 1997 Asian financial crisis. It may offer some clues on how small businesses experienced economic contractions compared to larger businesses although the coronavirus impact will likely differ in severity and duration from the past two crises.

Some of the proposals to support the SMEs are:

1. **Revenue-based financing as opposed to using the traditional and past credit scoring for enterprises (like CCRIS/CTOS);**
2. **Mitigate supply chain disruptions by having targeted lending/cushions based on supply chain bottlenecks, and helping businesses weather these disruptions could be straightforward and time-limited, especially as China's economy moves back to normal ahead of the US economy;**
3. **Income support tax credit by looking at a new "epidemic tax credit" that functions both as income support and as a way to offer paid leave;**
4. **Wage insurance by looking at the practices in Europe that use "working time accounts" to help employers manage their workforce more flexibly without pushing people onto the unemployment rolls;**
5. **Delay tax payments as many SMEs are in the midst of the liquidity crunch;**
6. **Payment flexibility where the government could help offer flexibility in how those institutions collect payments from small businesses such as principal-only payments, or other flexible options could be considered;**
7. **Targeted assistance for micro and small businesses as they are likely to bear a bigger brunt of the negative impact and may not qualify for loans or any financial assistance; and**
8. **Assist in the debt-service obligations.**

A. Virus impact on revenue

- The impact from the coronavirus pandemic has led to drastic measures to keep people at home. Everywhere, governments are halting international travel, ordering people to stay home, and shuttering non-essential businesses. These measures are designed to slow the spread of the global pandemic virus and keep people safe.

- Global economy is expected to be in recession in 2020. We have lowered our growth projection to 0.8% from 2.8% previously (Chart 1). The last time global economy dipped into a recession was during the 2008 global financial crisis (GFC), during which the economy shrank by 0.1%. Back then, Europe, Japan, and the US went into a prolonged negative growth. China's GDP dropped to 6% from 10%, somewhat implying a recession.

- This unprecedented impact from the Covid-19 outbreak is seen hurting the global economy on two aspects i.e. supply and demand. The spreading of the virus in Europe and the US after hitting Asia has disrupted and dislocated the global economy, supply chains, shipping, total trade and markets. Worsening the situation is the sudden stop to economic activities through quarantines, event cancellations, and social distancing. Also, financial market chaos erupted in the fear of a liquidity crunch.

- Demand is impacted with the drop in consumer spending since consumers are unable to spend on the usual purchases of goods and services due to the lack of availability and loss of confidence. With higher job losses, consumer spending is expected to take a hit as their purse strings are tightened.

- In line with our downwards revision on the global GDP, we reduced Malaysia's growth to 0.4% with the downside at -2.0, from previously 3.0% As a result, SME growth for 2020 was lowered to 1.9% with the downside at -0.5% from previously 6.0%. (Chart 2).

- With the downgrade on both the national and SMEs GDP for 2020, Table 1 presents the projected loss. The estimated loss at the national level is between RM58bil and RM92bil from our initial projection of 4.5% GDP for 2020 while for SMEs is between RM23bil and RM36 billion based on the initial growth of 6.0%.

- Focusing on SME average per day income, it has been reduced to RM0.03 billion based on a 1.9% SME growth from RM0.09 billion previously at 6.0% growth. And the risk for SMEs' average per day earnings to shrink cannot be ruled out, estimated at -RM0.01 billion.

- The movement control order (MCO) which started on 18 March has dented SMEs businesses, particularly the micro businesses and independent business owners — especially those in the infancy of their entrepreneurial journey. This segment of SMEs businesses makes up 77% of the total SME establishments, while the small business segment accounts for about 21% and medium businesses make up 2% .

- With services accounting for 62.4% of total SME business, many in this area of business have been forced to close their doors. Some may not reopen. The pressure on SME manufacturing which makes up 20% of the total business is also high. Apart from the loss of revenue, they are also impacted by poor credit standings. And even if the MCO is lifted by mid-April or end April, we expect demand to be weak for some time due to travel aversion and social distancing.

- Besides, exports will stay weak from lockdowns. Commodity prices will stay soft. The drop in consumer and corporate spending will intensify the adverse chain reaction that will fuel the collapse of micro businesses, especially the younger and smaller businesses due to their highly vulnerable situation. Generally, the older and larger small businesses are more likely to withstand an economic crisis.

- The risk of bankruptcies and rising bad loans are concerning factors. This is because of their poor credit standings. SMEs lack cash or assets that can be converted quickly to cash to operate their business as they will be faced with short-term obligations. Vendors and suppliers might not be willing to wait a long time for their payment. These businesses risk facing: (1) vendors who stop supplying the raw materials needed to produce the products; (2) the inability to pay their interest on loans to the bank; and (3) unforeseen emergencies and unexpected expenses.

- Also, there will be considerable job losses although these are expected to vary considerably according to the age and size of the small businesses. The concern is on micro businesses. Although these businesses usually have fewer than 10 employees, especially young businesses between zero and five years old, they are highly vulnerable in terms of jobs and revenue. SMEs provide around 9.9 million jobs in 2018 and projected at 10.1 million in 2019, making up 66% of the job market (Chart 3).

B. The need to support SMEs

- The spread of the global pandemic virus has undoubtedly affected our economy. We cannot stop this, but we can make a choice with our ringgit to help local economies to stay afloat and give small businesses a chance to rebound when we come out from this crisis. Companies that began in homes or coffee shops have grown and fostered the eco-system that allows other small businesses to thrive. Entrepreneurship stimulates as well as facilitates more entrepreneurship.

- In terms of local businesses, the impact is even more obvious. When we buy local, our ringgit stays in the community and helps local development through the positive multiplier effect. For example, a restaurant buying ingredients from local producers uses a local insurance broker and hires a local design firm, building symbiotic relationships that help the whole business community prosper.

- Besides the economic impact, supporting small businesses also helps socially. Small businesses, especially in the case of retail stores, are often major contributors to the heart of a community. "Main Street" becomes a hub of activities, where stores, business associations and local government work collectively to create and preserve the character of their town or neighbourhood.

- A deliberate focus on supporting local businesses helps drive up the appeal of the shopping area and attracts tourism dollars into the community. The effect has a positive impact on adjacent hotels, attractions and tours. Also, it helps creates job, lets people learn on-the-job business skills, and empower the next generation of entrepreneurs. With retail businesses closing due to the virus impact, now is the time for us to rally around the small business community.

- In terms of sustainability, although this may not be true in every case, still there are signs where the smaller businesses may have a shorter manufacturer-to-consumer journey. It means that there is more transparency in ingredients, materials and the source of the products they buy. Small businesses are often makers, producing goods locally. Or they are resellers of products made by small brands.

- Smaller brands often have the means to manufacture and source locally and ethically because of smaller quantities. One may pay more for these goods versus similar items at chain retailers, but one could be paying for the peace of mind that comes with ethical production.

- Large brands have recognized that the intimacy and personalized care of small businesses is hard to scale. Many new business owners launch alone and fill every role in the business, including customer service. Without the layers of management and corporate policy, small business owners can bend their own rules — and good ones will bend over backward for each shopper — because every single customer matters when you are small.

- Shopping with small businesses is often a point of discovery. Smaller, local and handmade brands often are unable to meet wholesale orders for larger chains. Their goods can generally only be found direct from the brand's own website or sales channels, or in independent retailers. Where department stores win on volume, small businesses shine in diversity and uniqueness.

C. Policy measures

- While the need to help the micro business community is most immediately obvious, the benefits of shopping small extend beyond times of crisis. We are all social distancing, which means our ringgit is not flowing into local cafés and gyms and bookstores. But many of these businesses have made clever pivots to service their customers without human contact. There are ways that we as a community can secure the future of our local small businesses and help them shine in these dark times.

- Beyond their size, small businesses are defined by their spirit. And at the helm are their intrepid founders — scrappy, ambitious, and resilient. They invent and build things despite uncertainty, because it's what drives them. Their risks lead to innovation that moves the world forward. And we need them.

- Competition from chain stores, skyrocketing retail leases, and struggles to secure funding or manage cash flow all contribute to well-known small-business failure rates. But small businesses are important to the economic and social fabric of our society, and we all play a part in their survival.

- Some of the proposals to help SMEs are:

1. **Revenue-based financing (RBF):** As opposed to using the traditional and past credit scoring for enterprises (like CCRIS/CTOS), the focus should be on the need for working capital i.e. using RBF. This is a type of financial capital provided to small or growing businesses in which investors inject capital into a business in return for a fixed percentage of ongoing gross revenues. Payment increases or decreases based on business revenues, typically measured as either daily revenue or monthly revenue. Usually the returns to the investor will continue until the initial capital amount, plus a multiple (also known as a cap) is repaid. Generally, RBF investors expect the loan to be repaid within 3 to 5 years of the initial investment. This mode of financing has provided significant advantages to entrepreneurs and businesses. The nature of RBF is that it requires businesses to have two key attributes i.e. generating revenue and good gross margins to accommodate the percentage of revenue dedicated to loan payments.

2. **Mitigate supply chain disruptions:** There is a need to mitigate supply chain disruptions just like providing disaster loan where the focus should not just be on low-interest loans, but also other measures to helps businesses meet payroll, make debt payments, and pay other bills. In mitigating the supply chains disruptions, there is a need to have targeted lending/cushions based on supply chain bottlenecks. Many small businesses are either facing disruptions in their own supply chains — especially from the impact of Covid-19 in China — or are part of a supply chain facing difficulties from knock-on effects. Helping businesses weather these disruptions could be straightforward and time-limited, especially as China's economy moves back to normal ahead of the US economy.

3. **Income support tax credit:** In response to demand shortfalls, many small businesses will respond by reducing working hours for employees or dismissing them altogether. Many will intend to rehire them when the crisis passes and the rebound kicks in. To help businesses avoid layoffs (and all the social and psychological costs they come with), we need to look at a new "epidemic tax credit" that functions both as income support and as a way to offer paid leave.

4. **Wage insurance:** It will be another approach to help small businesses avoid layoffs by reducing hours and providing support to fill the gap of missing wages. We could look at the practices in Europe that use "working time accounts" to help employers manage their workforce more flexibly without pushing people onto the unemployment rolls.

5. **Delay tax payments:** Many small businesses (and the self-employed) will be making quarterly estimated tax payments. Those payments will come at a time when small businesses are in the midst of the liquidity crunch. Delays and abatements for these payments could go a long way in helping mitigate the Covid-19 recession impact.

6. **Payment flexibility:** Even if small businesses receive assistance, they may still have trouble meeting obligations such as rent and loan payments. In its support for financial institutions, the government could help offer flexibility in how those institutions collect payments from small businesses such as principal-only payments, or other flexible options could be considered.

7. **Targeted assistance**: During this crisis, assistance could be targeted more to micro and small businesses which make up the lion's share of the SME total establishments, around 98%. They are likely to bear a bigger brunt of the negative impact. Many are unable to qualify for loans or any financial assistance.

8. **Debt-service obligations:** To assist SMEs meet debt-service obligations, there is a need: (1) to extend the loan tenure; (2) for longer credit terms from suppliers; (3) for the government to start paying their dues on time so that more money will go to businesses faster; (4) for large GLCs to start paying their suppliers on time so that money can go out fast; and (5) to relax the rules for housing development so that developers can pay the contractors faster as a large chunk of contactors are SMEs.

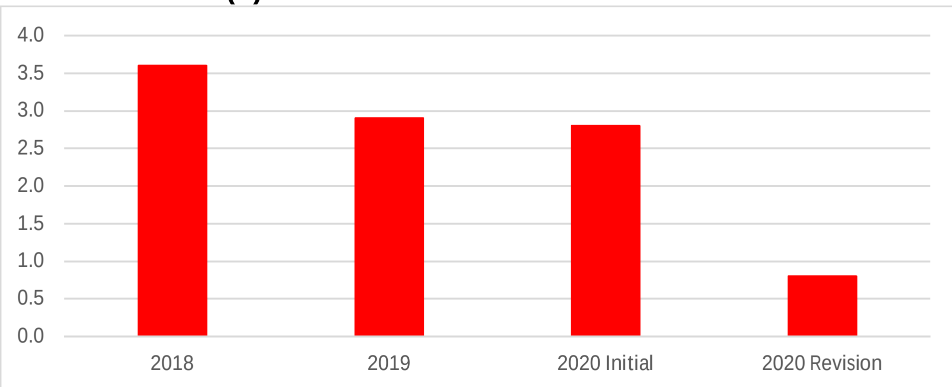
D. Conclusion

- Not every small business is equipped to survive this downturn. And because small businesses contribute disproportionately to job loss during recessions, policy responses are necessary. In our current crisis, these measures must occur immediately — which means that speed and simplicity are important considerations.

- If speed and simplicity are required in the short term, then "scale" is the operative word for the medium-term recovery. In the long term, policymakers and business development providers should remember that the 2008 GFC was distinctly damaging to SMEs. And that was at a time when shops and restaurants could still rely on social interaction and foot traffic for business. Covid-19 has stripped even that advantage away. This crisis will demand a set of policy support measures that are both broader and longer term than those pursued in 2009. Otherwise, small businesses are certain to face a calamity. Also, it can be challenging to now meet the 41% contribution target from SMEs to GDP in 2020 if left unattended.

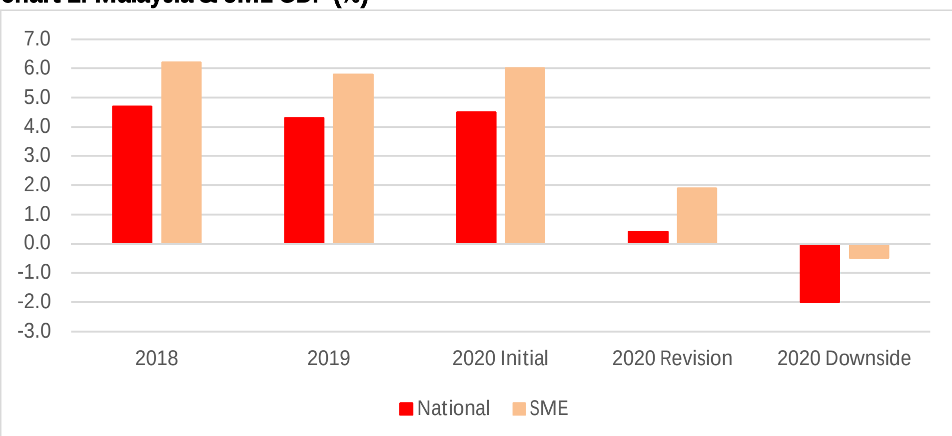
- Thus, measures should look into post-coronavirus rebuilding of the economy. There must be a single government-backed public-private partnership agency tasked to rebuild the SME economy. Hence, it will be vital to look back at what happened to SMEs during the 2008 GFC and probably as far back as the 1997 Asian financial crisis. It may offer some clues on how small businesses experienced economic contractions compared to larger businesses although the coronavirus impact will likely differ in severity and duration from the past two crises.

Chart 1: Global GDP (%)



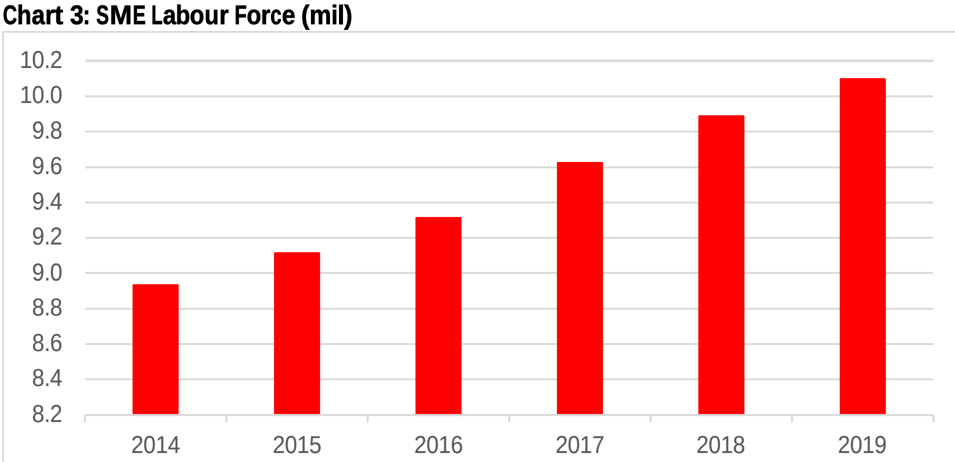
Source: AmBank Research/CEIC

Chart 2: Malaysia & SME GDP (%)



Source: AmBank Research/CEIC

Chart 3: SME Labour Force (mil)



Source: SMECorp/AmBank Research

Table 1: Sensitivity Analysis of Revenue Gain/Loss (RM bil)

	Revenue (RM bil)		Against 2019 (Gain/Loss: RM bil)		Against Initial 2020 Forecast (Gain/Loss: RM bil)	
	National	**SME**	**National**	**SME**	**National**	**SME**
2019	1421	552				
2020 Initial	1485	585	64	33		
2020 Revision	1427	562	6	10	-58	-23
2020 Downside	1393	549	-28	-3	-92	-36

Source: AmBank Research/CEIC

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