

STRUCTURAL POLICY
COUNTRY NOTES

Malaysia



Malaysia

A. Medium-term economic outlook (forecast, 2013-17 average):

GDP growth (percentage change):	5.1
Current account balance (% of GDP):	6.2
Fiscal balance (% of GDP):	-4.8

B. Medium-term plan

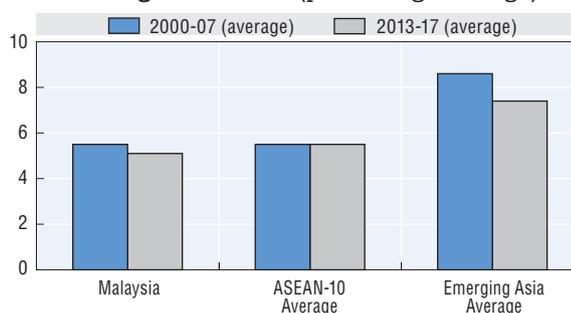
Period:	2011-15
Theme:	Charting development towards a high-income nation

C. Basic data (in 2011)

Total population:	29 million*
Population of Kuala Lumpur:	1.7 million (in 2010)
GDP per capita at PPP:	15 568 (current USD)

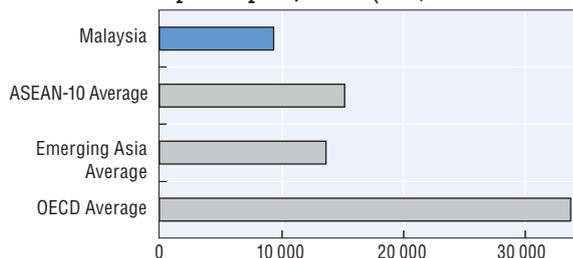
Note: *Total population data for 2011 is an estimate.
Sources: OECD Development Centre, MPF-2013, national sources and IMF.

GDP growth rates (percentage change)



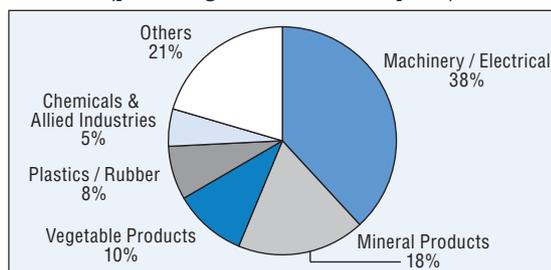
Source: OECD Development Centre, MPF-2013.

GDP per capita, 2011 (PPP, current USD)



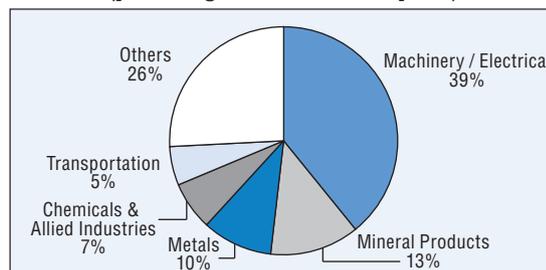
Source: IMF and national sources.

Composition of exports in 2011 (percentage share of total exports)



Source: Trademap.

Composition of imports in 2011 (percentage share of total imports)



Malaysia will need to address some important long-standing economic weaknesses in the medium term in order to progress toward becoming an advanced economy within the next decade. Skill shortages and mismatches and the deficiencies in the education system that underlie them and the low participation of women in the workforce particularly need to be remedied. Measures to improve small and medium enterprise (SME) productivity and to reduce gaps between rural and urban SMEs will also be needed.

Malaysia's medium-term policy challenges and responses

- Strengthen TVET and the education system to address skills shortages
- Address weaknesses in labour market functioning
- Enhance productivity of SMEs

POLICY FOCUS

Strengthen TVET and the education system to address skills shortages

Intensifying human capital development is a critical need

The Malaysian government has introduced a national transformation framework which aims to drive the country toward an advanced nation by 2020. Three pillars of the framework, the New Economic Model (NEM), the Economic Transformation Programme (ETP), and the 10th Malaysia Plan (2011-2015), have underscored the critical role of a highly skilled, creative and innovative workforce in achieving a high income economy that is both inclusive and sustainable.

Presently, the talent base of the workforce of Malaysia has lagged behind the standard of high-income nations.¹ The country suffers from a shortage of skilled workers, weak productivity growth stemming from a lack of creativity and innovation in the workforce, and an over-reliance on unskilled and low-wage migrant workers (National Economic Advisory Council, 2010).

In 2010, 58.0% of the Malaysian labour force had only a secondary level education, 13.2% had primary level education and 2.6% had no formal education. That implies nearly three-quarters (73.8%) of the Malaysian labour force in 2010 is low-skilled. An also noteworthy point is that more than 47% of non-Malaysian citizens in the labour force, i.e. migrant workers, had only a primary level education.

The Malaysian government has realised that the present education system needs a complete overhaul if the country is to transform itself into a knowledge- and innovation-based high income economy. The Malaysia Education Blueprint 2013-2025 was launched in September 2012 as the latest initiative of the government to transform the education system into one that produces thinking and innovative students to meet the needs of the new economy.

Employers' over-reliance on unskilled and cheap foreign labour has led to inadequate growth of skilled workers in the labour market. As a result, only 25% of Malaysia's labour force is composed of highly skilled workers, as compared to significantly higher proportions in Singapore, Chinese Taipei and Korea. The inadequately educated labour force of Malaysia has become the main obstacle to business operations and growth. Businesses in Malaysia, including SMEs, face increasing difficulties in recruiting and retaining skilled workers at the technical, supervisory and managerial levels (National SME Development Council, 2012).

Such difficulty has intensified as the mismatch between skills needed by the labour market and those acquired by job seekers has worsened. More than 40% of firms have reported vacancies for skilled production worker positions, and the average time

required to fill a vacancy is about four weeks (World Bank, 2009b). The main reason given by the firms for this long process is that the applicants did not have the required basic skills or the right technical skills needed to carry out the jobs in question. The evidence of skills mismatch is further indicated by the relatively high unemployment rate of graduates (Table 2.3.1). A survey by the Ministry of Higher Education (MOHE) in 2008 shows that about a quarter of graduates of university and colleges remained unemployed six months after completion of their studies. For those who secured jobs, almost one-third were in jobs at a lower skill level than they were trained for (National Economic Advisory Council, 2010).

Table 2.3.1. Employment status of 2006 and 2007 graduates at the end of 2008 in Malaysia, by institution type and level
(percentage)

Employment Status	Institut Pengajian Tinggi Awam (IPTA)*		Institut Pengajian Tinggi Swasta (IPTS)**	
	Bachelor's level	Below Bachelor's level	Bachelor's level	Below Bachelor's level
Employed	73.1	46.8	77.5	57.2
Waiting for placement	3.1	0.7	0.4	0.5
Pursuing further study	6.6	27.4	2.9	11.4
Unemployed	17.1	25.1	19.1	30.8

Notes:

* Public Higher Education Institution.

** Private Higher Education Institution.

Source: Malaysia Economic Monitor 2011, Table 16, p.57.

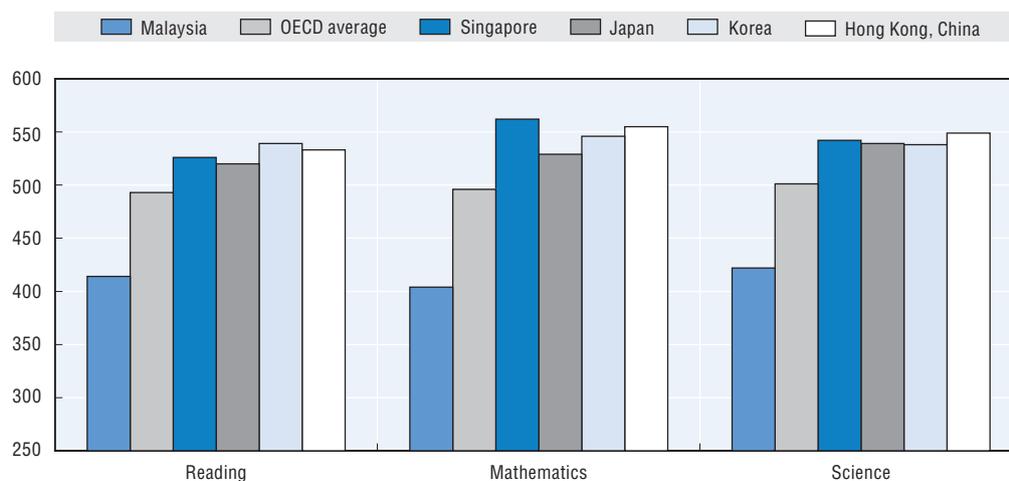
While the government has been trying to raise the skill-level of the labour force by broadening the access to technical and vocational education and training (TVET), the take-up rate is still low. Only 10% of students enrol in upper level secondary technical and vocational education, much lower than the average enrolment rate of 44% for OECD countries (EPU, 2010). Moreover, as a recent assessment of the Malaysian National Dual Training system by Pang (2010) shows, skill-training programmes remain mismatched with industry requirements in Malaysia, partly because the private sector has not been given a sufficient role in shaping the programmes.

The education system needs to be reformed to produce students with strong analytical and problem-solving capabilities, a good command of English, and effective social networking skills. These qualities are of great importance in the adoption of cutting edge technology and in the promotion of knowledge generation and innovation. Malaysia is increasingly at risk of falling behind competitor countries as the quality of its education is declining. In 1999, Malaysia's performance in the Trends in International Mathematics and Science Study (TIMSS) 8th Grade Mathematics and Science was well above the international average. The 2007 results, however, fell below the international average. In the three types of cognitive skills assessed (knowledge recall, the application of knowledge in solving problems and the ability to reason in working through problems), Malaysian students have lagged behind the performance of their counterparts in the high-income economies in the region.

According to the OECD's Programme for International Student Assessment (PISA) 2009 Plus assessment, Malaysia performed in the bottom third for reading, mathematics and science, well below the international and OECD average in all three areas (Figure 2.3.1). Malaysia's performance was at least 100 points below that of regional peers such as Singapore, Japan, Korea and Hong Kong, China on all three dimensions. Almost 60% of Malaysian students did not meet the minimum benchmarks in mathematics – the

baseline proficiency required for students to participate effectively and productively in life. Similarly, 44% and 43% of students do not meet minimum proficiency levels in reading and science respectively (Ministry of Education Malaysia, 2012).

Figure 2.3.1. OECD PISA 2009 Plus results in Malaysia and other Asian economies (score)



Note: PISA scale was set such that approximately two-thirds of students across OECD countries score between 400 and 600 points. Gaps of 72, 62 and 75 points in reading, mathematics and science scores, respectively, are equivalent to one proficiency level.

Source: Walker, M. (2011), *PISA 2009 Plus Results: Performance of 15-Year-Olds in Reading, Mathematics and Science for 10 Additional Participants*, Australian Council for Educational Research (ACER), Victoria.

StatLink  <http://dx.doi.org/10.1787/888932774395>

The quality of an education system is to a large extent dependent on the quality of its teachers. Weaknesses in teacher competencies are a serious impediment to overall education quality in Malaysia. A 2011 research study found that only 50% of lessons were being delivered in an effective manner. The other 50% of the lessons were focused on achieving superficial content understanding, instead of higher-order thinking skills. The study also reported that in a sample of over 7 500 English teachers taking the Cambridge Placement Test, a significant number did not meet the minimum proficiency standard required for teaching English. The relatively low quality of applicants to teacher education institutes is probably partly responsible for the weakness in teacher competencies. In 2010, 93% of Bachelor of Education applicants at Teacher Education Institutes scored below the minimum academic requirement (Ministry of Education Malaysia, 2012).

Malaysia has achieved high participation rates at primary and secondary levels. In 2011, Malaysia achieved near universal enrolment at the primary level at 96% and 82% at upper secondary level (Ministry of Education Malaysia, 2012). Nevertheless, these rates are lower than that of the developed countries in the region. The participation rates of primary level for Japan and Korea have reached almost 100%; and the participation rates of upper secondary level for the two countries have consistently exceeded 90% (Ministry of Education Malaysia, 2012).

The achievement gaps between urban and rural schools remain a critical issue to be resolved. States with a relatively high proportion of students in rural schools, such as Sabah and Sarawak, perform more poorly than states with a lower proportion of students in rural schools. In the *Ujian Penilaian Sekolah Rendah* (UPSR, Primary School Evaluation Test) examinations, the gap between urban and rural students is almost 4 percentage

points in favour of the urban schools. At the Sijil Pelajaran Malaysia (SPM, Malaysian Certificate of Education) level, the gap appears to have widened to 8 percentage points (Ministry of Education Malaysia, 2012). Evidence suggests that students from poor families are likely to perform less well compared to students from middle- and high-income families. This socio-economic gap may help to widen the urban-rural disparity since rural income levels are generally below those of urban areas.

The government has instituted new reforms to address the weaknesses

The government of Malaysia recognises the need for bold measures to improve the country's human capital weaknesses in order to develop a workforce talent base comparable to the standards of regional peers and high income nations. Initiatives to address the problems of skills shortages and mismatches and declining education quality are central in many of the ongoing and more recent government initiatives.

The 10th Malaysia Plan details an integrated human capital and talent development framework which streamlines the major policy measures introduced in various initiatives (Table 2.3.2).

Table 2.3.2. The Integrated Human Capital and Talent Development Framework in Malaysia

Theme	Strategy
a) Revamping the education system to significantly raise student outcomes	<ul style="list-style-type: none"> • Ensure that every child can succeed • Hold schools accountable for changes in student outcomes • Invest in head teachers and principals as the primary drivers of change • Attract and develop top talent in the teaching profession
b) Raising the skills of Malaysians to increase employability	<ul style="list-style-type: none"> • Mainstream and broaden access to quality technical and vocational training • Enhance the competencies of tertiary graduates to prepare them for entering the labour market
c) Reforming the labour market	<ul style="list-style-type: none"> • Make the labour market more flexible • Upgrade the skills and capabilities of Malaysia's existing workforce • Enhance Malaysia's ability to attract and retain top talent

Source: 10th Malaysia Plan.

The newly released Preliminary Report for Malaysia Education Blueprint 2013-2025 marks the latest government initiative to revamp the education system. The Blueprint establishes the visions and aspirations for the Malaysian education system and lays out a roadmap of policies and initiatives that will be undertaken in order to achieve these goals (see Appendix).

Stronger efforts are needed on TVET and education reforms to improve workforce competencies

The pivotal need is to improve the competencies of the workforce. This will require direct measures to improve workforce skills and broader reforms to enhance the performance of the education system.

Given the need to improve workforce capabilities at a rapid pace, policies to raise the skills of Malaysians need to focus on three areas. First, the participation rate in TVET needs to be raised and the quality of the TVET curriculum needs to be upgraded. The presently low enrolment rate for TVET in Malaysia suggests that there is huge untapped

potential to expand TVET training and thereby increase the supply of skilled workers. Towards this end, the government should carry out campaigns to increase the awareness of students and parents about the benefits of TVET. In addition, the TVET curriculum needs to be upgraded to bring it into better alignment with industry requirements. Broadening collaboration and networking of TVET programmes with industry players will expose TVET students to up-to-date technological skills in the workplace and thus increase their employability.

Second, the competency of graduates in technical skills as well as soft skills needs to be enhanced. Industry players should be engaged in TVET programmes and research collaboration, as these initiatives will enhance the practical knowledge and business skills of TVET graduates as well as faculty members' awareness of industry needs. The effectiveness of the current Knowledge Transfer Partnership (KTP) programme also can be improved by deepening the engagement of industry players. In addition, course curricula of higher education institutions should be revised to place greater emphasis on soft skills development of students.

Third, the excessive reliance by businesses on unskilled foreign labour needs to be corrected by enforcing equal labour standards for local and foreign labour. When firms have access to large pool of low-cost workers, they tend to focus on short-term profits instead of striving to move up the value chain. This in turn undermines the creation of skilled job opportunities, which can impede productivity growth. The government should provide incentives for companies to upgrade their workforce.

To reverse the severe longstanding fall in standards and outcomes, policies to raise the performance of the education system should focus on the following areas.

First, the quality of those entering the teaching professions needs to be improved by making teaching a profession of choice instead of a profession of last resort. Incentives should be given to attract the best graduates who have a passion for teaching to join the profession. The proposal by the Ministry of Education to raise the entry bar for joining the teaching profession to the top 30% of graduates, as outlined in the Preliminary Report for Malaysia Education Blueprint 2013-2025, is a useful step in this direction. Second, performance incentives of teachers need to be strengthened by replacing the current system of permanent tenure for teachers with performance-based contractual employment. The present life-time employment system fails to adequately encourage teachers to constantly upgrade their teaching abilities. Introducing performance-based contractual employment to new recruits would provide flexibility to dismiss poorly performing teachers. Third, pre-school enrolment needs to be expanded and the quality of the pre-school programme improved. Research shows that children who enrol in pre-school programmes tend to be more committed to learning and earn higher incomes in later years. More efforts should be channelled into getting the children of poor rural families into pre-school programmes by raising the awareness of their parents about the importance of pre-school education and by providing financial assistance to the families. Fourth, more resources need to be allocated to poorer performing rural schools in order to narrow the achievement gaps between urban and rural schools. The performance of rural schools has been at the bottom quartile for all schools. The long-standing problems of rural schools, including poor infrastructure and teacher shortages, have contributed to the low performance of rural schools. More resources for infrastructure upgrading should be given to rural schools. Financial incentives should be given to attract teachers to teach at rural schools.

POLICY FOCUS

Address weaknesses in labour market functioning

A number of steps to address weaknesses in labour market performance would enhance the benefits of the efforts to improve human capital. Measures to encourage greater female participation in the work force would be particularly beneficial. Other useful policies include steps to reduce barriers to hiring and firing to improve labour market flexibility and policies to improve service sector productivity.

Greater female labour force participation is needed

According to the Labour Force Survey Report 2010, Malaysia's overall labour force participation rate in 2010 was 62.7%. However the male participation rate, at about 77%, is much higher than the female participation rate of 44%. Malaysia's female participation rate is the lowest in the Southeast Asian region and well below that of China (68%) although above that of India (29%). Urban-based females in Malaysia have a higher rate of participation (48.5%), compared to their counterparts in the rural areas (41.2%), an indication of more job options for women in the urban areas, but the rate is still low by international standards.

The low female participation rate in the Malaysian labour force is due to, among other reasons, inflexible working arrangements and a lack of appropriate means to allow women to return to the workforce after leaving, for example to attend to family commitments. The benefits to Malaysia's economy from making better use of women's talents by improving female participation in the labour force are potentially very large. The government could institute policies to, among other things, reduce the inflexibility of working arrangements for females, and encourage the setting up of arrangements that make it easier for females to remain in the workforce and to return to the workforce after tending to family commitments.

Tangible steps to facilitate childcare centres in the workplace could help greatly to encourage greater female participation. Childcare centres contribute to overall labour productivity in three ways.

1. Increased labour force participation, both in terms of the number of jobs and hours worked per employee.
2. Higher lifetime earnings. Childcare centres allow parents to sustain greater continuity of employment, thereby helping them to maintain and improve their skills and to reduce absences from work that would otherwise reduce their incomes.
3. Lower absenteeism and turnover rates. By providing a reliable source of care, childcare centres can contribute to a stable and predictable workforce.

However, despite several government efforts, childcare centres in the workplace have not taken off as originally planned. More incentives may be necessary.

Other issues also need to be addressed

In addition to policies to improve female participation, three other areas need to be addressed. First, hiring and firing practices need to be made less cumbersome so that employers can adjust their labour forces to changing market conditions at a reasonable cost. Malaysia's labour regulations related to hiring and firing are relatively cumbersome, which undermines efficiency and competitiveness. For example, Malaysian employers are required to pay 24 weeks of wages to employees being made redundant, compared to three weeks in Singapore. Policies that make the process less cumbersome and less costly would thus provide a more conducive environment for businesses to operate.

A second important issue is the emigration of skilled workers and professionals from Malaysia to other countries ("brain drain"). According to a World Bank report, the Malaysian brain drain has contributed to the narrowing of an already narrow skill base and deterioration in its overall quality. This has worsened the mismatch between skills supplied and needed, and has resulted in sub-optimal hiring policies and productivity losses at the firm level.

To address the brain drain and the problems it creates, the government has put in place measures aimed at enhancing Malaysia's ability to attract and retain top talent. A serious attempt to stem brain drain would however require moving Malaysia's controversial affirmative action policies to a need-based system.

Finally, policies are also needed to boost productivity growth, especially in the services sector. The majority of employed persons (57% in 2010) in Malaysia are employed in the services sector, which contributes about 55% of national output. There has been almost no growth in labour productivity in the services sector (as measured by value added per unit of worker) during the 1993-2005 period. In 2005, labour productivity was about USD 7 700 (in 2000 USD), virtually the same as its level in 2003. In addition, labour productivity in the Malaysian services sector in 2005 was less than half that of Korea, and 10% that of Japan.

Policies may also be needed to reinvigorate productivity growth in manufacturing. Labour productivity growth in the nine major manufacturing industries slowed during 2004-06, increasing by only 2.2% per annum, compared to 5.5% per annum during the 1999-2001 period. However, Malaysia's labour productivity in the manufacturing sector is still noticeably higher than that of most other countries in Southeast Asia, notably that of Thailand, the Philippines and Indonesia.

The new minimum wage law will benefit low income workers

The Minimum Wage Order 2012, which has been gazetted, will take effect on 1 January 2013 for employers who employ six or more workers. The national minimum wage has been set at MYR 900 (Malaysian ringgit) in Peninsular Malaysia and at MYR 800 in East Malaysia (Sabah, Sarawak and Labuan). The institution of the minimum wage will help to reduce poverty and improve incomes of lower skilled workers but it could have adverse impacts on some firms now on the margin of profitability.

Assuming that current firm productivity levels (at the national level) are similar to the levels that existed during the period when the Census of Establishments and Enterprises 2005 (see Table 2.3.3 below) was being undertaken by the Department of Statistics Malaysia, most firms in the manufacturing, services and agricultural sectors

are unlikely to face much impact from the implementation of national minimum wage. That is because the maximum wage the firms in each of these three sectors would be able to pay their workers without making an operating loss, which would be equivalent to the value added per worker, are way above minimum wage.

Table 2.3.3. Value added per worker in Malaysia, by sector and state

State	Value added per worker (MYR) per annum		
	Agriculture	Manufacturing	Services
Total	34 756	60 174	46 848
Johor	42 484	67 509	43 771
Kedah	9 684	33 903	27 301
Kelantan	8 170	16 439	15 861
Melaka	41 244	48 965	36 766
Negeri Sembilan	30 394	55 556	23 831
Pahang	45 450	90 491	31 114
P Pinang	34 701	59 487	38 014
Perak	37 498	40 154	21 327
Perlis	9 226	26 786	45 836
Selangor	32 770	61 609	29 259
Terengganu	13 291	56 035	35 523
Sabah	61 809	49 025	61 586
Sarawak	52 883	136 489	18 592
W.P. Kuala Lumpur	73 333	43 997	62 863

Source: Census of Establishments and Enterprises 2005 - Profile of Small and Medium Enterprises, DOSM.

When considering state-level impact of national minimum wage implementation, however, there could be material impact on agricultural firms based in the less developed states, notably Kelantan, Perlis and Kedah, where agriculture productivity levels are considerably below the national average.

Table 2.3.4 below shows that workers in the following job categories - skilled agricultural and fishery workers, plant and machine-operators and assemblers, and elementary workers – are expected to benefit most in terms of higher wages arising from the implementation of a national minimum wage.

As indicated in the table, females are paid on average less than males in the workplace. Due to family responsibilities, females are less mobile compared to men and therefore have a narrower set of employment options. These limitations depress their earning opportunities; they are also more vulnerable than men to the monopsony power of employers. A well-regulated minimum wage policy should thus benefit women relatively more than men, by increasing their average monthly pay, and by at least partly offsetting their relatively weaker bargaining power relative to that of their employers.

Table 2.3.4. Average monthly basic wage of workers in Malaysia, by gender and job category

Job category	Male (MYR)	Female (MYR)
Senior officials and managers	4 296	2 522
Professionals	3 670	2 848
Technicians and associate professionals	2 007	1 957
Clerical workers	1 407	1 325
Service workers, shop and sales workers	924	802
Skilled agricultural and fishery workers	730	513
Craft and related trades workers	1 081	727
Plant and machine operators and assemblers	860	623
Elementary workers	693	561
Total	1 473	1 239

Source: National Employment Returns Report 2008, Ministry of Human Resource.

The introduction of a national minimum wage will increase the marginal cost of producing a given level of output. Producers who are significantly affected will need to charge higher prices, resulting in a lower amount of demand for their products. This in turn could reduce the demand for capital and depress investment.

However, whether a national minimum wage will reduce foreign direct investments (FDI) and/or domestic investments (DI) will depend on the characteristics of the industry and of its business operations, in particular whether the operations are low-skilled low-wage labour-intensive or high-tech high-skilled high-wage capital-intensive type.

Only the former industries are likely to experience significant cost increases from the minimum wage. Considering that Malaysia's current development strategy aimed at Vision 2020 calls for investments in high-tech high value-adding industries that require high-skilled labour, the impact on investment at the aggregate level is not likely to be significant.

POLICY FOCUS

Enhance productivity of SMEs

Of the total business establishments in Malaysia, 99.2% are SMEs. SMEs are very important contributors to the Malaysian economy, accounting for 32% of national GDP, 59% of employment and 19% of exports.

A wide range of businesses, differing in dynamism, technical advancement and risk attitude, make up the SME sector. The services sector in Malaysia has the largest share of SMEs – 87%. The manufacturing sector has 7%, while agriculture has 6%.

Microenterprises make up the bulk of SMEs (79%). By location, the Klang Valley (located in the state of Selangor and the federal territory of Kuala Lumpur) has the largest number of SMEs (35.7% of the national total), followed by Johor (10.3%), Perak (8%) and Kedah (6.8%).

Compared to its regional peers as well as those in the more developed nations, Malaysian SMEs are characterised by: i) relatively low productivity; ii) lower business formation rates than in high income nations; iii) concentration of output and employment in a relatively small number of firms; and iv) a high share of SMEs operating in the informal sector.

Disparities in productivity between of urban and rural SMEs are large

According to the SME Masterplan, SME labour productivity in Malaysia is low relative to productivity levels in the Southeast Asian region and in more advanced countries. In 2010, the productivity of Malaysian SMEs is estimated to average MYR 67 174 per worker (about USD 22 100); SMEs in Singapore and the United States, on the other hand, were four times and seven times more productive respectively.

Not only are there disparities in performance between Malaysian SMEs and their counterparts overseas, especially in the more advanced countries, there are also disparities between rural- and urban-based firms.

Studies have shown that the effect of location on productivity can vary with type of industry, its size, and the timing of a firm's entry into the industry. Because of the many factors that can influence the effect of location on productivity, the reasons for the rural-urban disparity in SME productivity is not clear from available statistical data. For example, value added per worker in the federal territory of Kuala Lumpur, the nation's capital, is below the national average; it is even below that of the state of Sabah, a relatively less developed state in East Malaysia. Sarawak, another relatively less developed state in East Malaysia, on the other hand, registered a value of more than twice that of the national average.

The results of an unpublished Vistage Malaysia survey highlight the disparities between rural and urban SMEs in Malaysia and provide insight into the factors behind them. According to the survey results, urban-based Malaysian SMEs place high priority on productivity improvements owing to their focus on breaking into export markets. There is a great need to employ advanced technology and become more competitive in order to be able to meet the quality requirements of their customers – particularly multinational companies, as well as large local companies.

Rural-based SMEs, on the other hand, tend to cater mainly to the domestic market, whose requirements are less sophisticated than those of export markets. Hence, rural-based SMEs find traditional, low-volume, low-cost modes of production using low-technology machinery sufficient for their business operations. These differences are partly explained by the generally lower entrepreneurial and managerial skills of owners of rural versus urban-based SMEs. The result is lower productivity levels.

Table 2.3.5. Principal statistics of SMEs in the manufacturing sector in Malaysia, by state

State	Number of establishments	Value added (MYR mn)	Number of persons engaged during December or the last day period, 2003	Value added per worker (MYR)	Value of assets owned as at 31 December (MYR mn)
Total	39 373	45 760	760 459	60 174.18	50 799
Johor	5 311	9 572	141 789	67 508.76	8 004
Kedah	2 637	1 740	51 323	33 902.93	1 765
Kelantan	1 845	318	19 344	16 439.21	414
Melaka	1 468	1 492	30 471	48 964.59	1 425
Negeri Sembilan	1 300	1 545	27 810	55 555.56	1 752
Pahang	1 632	2 304	25 461	90 491.34	2 680
P Pinang	2 456	3 506	58 937	59 487.25	3 544
Perak	4 023	2 601	64 775	40 154.38	2 823
Perlis	323	87	3 248	26 785.71	80
Selangor	7 747	10 805	175 379	61 609.43	10 673
Terengganu	1 784	1 012	18 060	56 035.44	1 584
Sabah	1 540	1 915	39 062	49 024.63	2 469
Sarawak	2 355	6 264	45 773	136 849.23	11 406
W.P. Kuala Lumpur	4 952	2 597	59 027	43 996.82	2 180

Source: Census of Establishments and Enterprises 2005 - Profile of Small and Medium Enterprises, Department of Statistics Malaysia.

According to the Vistage survey results, there is no noticeable difference between rural- and urban-based SMEs in terms of ease of access to credit facilities. As for awareness of government grants and incentives extended to SMEs, industry associations like the Federation of Malaysian Manufacturers, SME and trade associations are instrumental in helping disseminate such information. However, many SMEs, both rural- and urban-based, have not been successful in their applications for government grants and incentives because of deficiencies in the management of their businesses. Also, many non-bumiputra owned SMEs shy away from applying for government grants and incentives because the application forms, besides being complicated, require sensitive information that owners are not willing to divulge.

The SME Master plan 2012-2020 will improve the situation

During the 1960s, policies aimed at developing and promoting SMEs in Malaysia were mainly residual in nature. SMEs were given prominence only after the launching of the First Industrial Master Plan (1986–1995) to support Malaysia's industrialisation process. For example, the development strategies for SMEs under the First Industrial Master Plan focused on building linkages with larger firms and penetrating the export market.

The vision of the SME Masterplan, launched in July 2012, is to produce SMEs that can effectively compete on the global stage. The Masterplan seeks to raise the sector's GDP contribution to 41% from the current 32%. The Masterplan's four main objectives are: i) to increase business formation rate; ii) to expand the number of high-growth and innovative companies; iii) to raise productivity; and iv) to intensify re-entry of SMEs into the formal sector ("formalisation").

The SME development framework (the “Framework”) as set out under the SME Masterplan is aligned to the broader national aspirations of achieving the Vision 2020, which specifies a pathway of innovation-led and productivity-driven growth. The Framework has the following five elements: i) the vision for SME development moving forward; ii) the strategic goals towards achieving this Vision; iii) areas of focus for policy intervention to enhance SME performance; iv) an action plan to address the current challenges to growth; and v) the institutional capacity to support the implementation of the SME Masterplan.

The Framework specifies six areas of focus for policy intervention to enhance SME performance (Table 2.3.6).

Table 2.3.6. Focus areas to enhance SME performance in Malaysia

Focus areas	Policy measures
Innovation and technology adoption	Encourage greater innovation and technology adoption by SMEs.
Human capital development	Enhance human capital and entrepreneurship development among SMEs.
Access to financing	Ensure that creditworthy SMEs have access to financing for working capital and investment.
Market access	Expand market access for goods and services produced by SMEs.
Legal and regulatory environment	Ensure that the legal and regulatory environment is conducive for the formation and growth of SMEs, while protecting the broader interests of society.
Infrastructure	Improve the infrastructure required for SMEs to operate effectively.

Source: SME Masterplan 2012-2020.

A comprehensive action plan comprising 32 initiatives has been developed to overcome the challenges faced by SMEs in the above six focus areas. Each of the 32 initiatives will contribute towards achieving one or more of the SME Masterplan’s four objectives.

Supporting institutions and the business environment for SMEs need to be improved

Surveys and other information indicate that efforts in four areas are likely to be critical to the overall success of SME development in Malaysia.

First, there is a need to inculcate a productivity mind-set. The results of the Associated Chinese Chambers of Commerce & Industry of Malaysia (ACCCIM) 2012 SME Survey, in which only 11% of respondents indicated that the main focus of their innovation activities is to improve productivity, suggest that productivity is given too low a priority in SMEs. Measures should thus be put in place to change this attitude. OECD experiences provide potential lessons for helping SMEs to innovate through reforms to intellectual property regimes (IPR) that make it easier for smaller firms to obtain and use patents (see Box 2.3.1).

Second, the presence and role of supporting institutions, especially in rural areas, need to be increased. There is evidence to suggest that supporting institutions are not doing enough. The ACCCIM 2012 SME Survey revealed that 67% of respondents did not get any assistance from the key institutions tasked with promoting R&D and innovation

activities, namely: i) SIRIM;² ii) the Multimedia Development Corporation; iii) the Technology Park Malaysia; iv) the Malaysian Technology Development Corporation; v) the SME Corporation Malaysia; and vi) local universities/colleges.

In addition, the same survey revealed that a surprising 22% of respondents did not know of the existence of SME Corporation Malaysia, which is the central point of reference for information and advisory services for all SMEs in Malaysia. In the northern rural state of Kedah, for example, 39% of respondents indicated that they did not know of the institution's existence. Another noteworthy survey finding is that among those who were aware of the institution's existence, only 38% agreed with the statement that SME Corporation Malaysia is playing an active role in assisting SMEs.

Third, the services sectors need to be a key focus of the overall SME development strategy. The services sector is expected to remain as the main growth engine during the 10th Malaysia Plan period. And as SMEs have the biggest presence in the services sector (87%), SME development efforts must be skewed towards the services sector. This is not to suggest that the other sectors can be ignored. Also, since each sector is different, policy makers should be cognisant of the fact that there is no "one-size fits all" solution in SME development efforts.

Fourth, efforts need to be made to improve demand for SME products and services. One of the 32 initiatives in the Action Plan is to "mandate a specific Government procurement policy for SMEs", under which it is proposed that "Government-linked companies should be encouraged to procure from SMEs and invest in supplier development programmes targeting at locally owned SMEs". Such supplier development programmes should focus on rural-based SMEs, as well as industries "with characteristics that predispose them to the locations being supported".

Fifth, policy makers need to ensure that SMEs and other businesses can compete on a level playing field. This is the objective of Malaysia's Competition Act (2010) that came into effect on 1 January 2012. The Act is supposed to "ensure fair and healthy competition" and that "all will be protected, including the small and medium enterprises (SMEs)".

However, evidence suggests that open competition in Malaysia remains elusive. The following is a case in point. Some industry players have alleged that the government's "adoption" of some bumiputra pharmaceutical companies has resulted in the adopted companies being given five-year contracts to exclusively provide specific medication to the Health Ministry. These companies, which do not have to participate in an open tender for the product, also negotiate directly on price with the ministry.

Finally, SMEs would benefit from improvement in the e-commerce infrastructure. According to the ACCCIM 2012 SME Survey, 30% of survey respondents indicated that the main obstacle to them adopting e-commerce is poor bandwidth, followed by cost (25%) and concerns about e-payment security (20%). Respondents in Sabah and Sarawak meanwhile blamed limited network coverage for difficulties in adopting e-commerce.

Box 2.3.1. Increase SME's innovation potential through intellectual property rights: Examples from OECD countries

In a knowledge-based economy, SMEs play an important role in supporting innovation and as knowledge sources, thereby enhancing productivity growth. Thus, SMEs' management of intellectual property rights (IPRs) that facilitate the process of value creation from intellectual assets is critical. However SMEs face greater problems in benefiting from IPRs than larger firms due to the often complicated and lengthy procedures required by IPR frameworks.

OECD country experiences with "SME-friendly" initiatives within the intellectual property (IP) regulatory framework provide some potential lessons as to how these problems can be reduced.

In **Australia**, an alternative and simplified patent filing system was introduced (Innovation Patent System) in 2001, in order to protect inventions that do not meet the threshold required for standard patents.

In the **United Kingdom**, similarly to Australia, recent reforms have aimed at creating a more simplified, streamlined and user friendly IP system. In 2003, the option for a streamlined procedure was introduced in order to speed up dispute resolution. Since 2005, the United Kingdom Patent Office has been providing key information to potential patent applicants in order to improve the quality of applications. In 2010, new procedures aimed at further simplifying and reducing the cost of the patent litigation process were introduced by the Patent County Court (PCC).

In the **United States**, the United States Patent and Trademark Office (USPTO) has implemented several measures to enhance its capacity and speed up the process of patent applications. For instance, an Ombudsman programme has been created to resolve breakdowns in the normal prosecution process, with senior examiners supporting applicants with unresolved issues. Furthermore, the 2011 reform bill gives the patent office the right to set its own fees and keep the proceeds to hire more examiners in order to increase the capacity to respond rapidly to applicants.

Based on OECD experience, the main policy recommendations for SMEs in order to exploit better their innovative and creative capacity are:

- Foster intellectual property education and training, bringing services and expertise closer to SMEs.
- Address SMEs' financial constraints in accessing intellectual property rights and provide strategic support.
- Make the intellectual property right system overall more "SME-friendly" by streamlining procedures and reducing application time, adequately structuring fees and costs, improving litigation and enforcement mechanisms.
- Improve cross-border information, co-ordination and enforcement.

Source: OECD (2011d).

Notes

1. According to the 10th Malaysia Plan (Chart 5-1, p.192), the percentage of labour force with tertiary education in Malaysia is 23.4% compared to OECD average 27.4%; only 28% of Malaysia's labour force is composed of skilled workers compared to OECD average 37.6%; labour productivity (USD PPP '000 per employee) is 26.6 compared to OECD average 64.8.
2. SIRIM, which is under the Ministry of Finance, is the agency responsible for research and technology development (www.sirim.my).

Appendix

Table 2.3.A1. **The Education Transformation 2013-2025 in Malaysia: Five System Aspirations, Six Student Aspirations, and Eleven Shifts to Transform the System**

Five System Aspirations	
Access	100% enrolment across all levels from pre-school to upper secondary by 2020
Quality	Top third of countries in international assessment such as PISA and TIMSS in 15 years
Equity	50% reduction in achievement gaps (urban-rural, socio-economic and gender) by 2020
Unity	An education system that gives children shared values and experiences by embracing diversity
Efficiency	A system which maximises student outcomes within current budget
Six Student Aspirations	
Knowledge	Student will be fully literate and numerate, be able to master core subjects such as mathematics and science, and is informed with a rounded knowledge of Malaysia, Asia and the world.
Thinking skills	Student will develop the ability to acquire new knowledge, to connect different pieces of knowledge, and to create new knowledge. S/he will master important cognitive skills, including problem-solving, reasoning, creative thinking and innovation.
Leadership skills	The education system will assist student to develop leadership skills that encompass entrepreneurship, resilience, emotional intelligence and communication skills.
Bilingual proficiency	Student should be operationally proficient in Bahasa Malaysia and English.
Ethics and spirituality	The education system will inculcate strong ethics and spirituality in every student to prepare them to rise to challenges, to resolve conflicts, to employ sound judgement and principles during critical moments, and to have courage to do what is right.
National identity	Every student will proudly identify as Malaysian, irrespective of ethnicity, religion or socio-economic status.
Eleven Shifts to Transform the System	
1. Provide equal access to quality education of an international standard.	
2. Ensure every child is proficient in Bahasa Melayu and English language.	
3. Develop values-driven Malaysians.	
4. Transform teaching into a profession of choice.	
5. Ensure high-performing school leaders in every school.	
6. Empower JPNs, PPDs and schools to customise solutions based on need.	
7. Leverage ICT to scale up quality learning across Malaysia.	
8. Transform ministry delivery capabilities and capacity.	
9. Partner with parents, community and private schools at scale.	
10. Maximise students' outcomes for every ringgit.	
11. Increase transparency for direct public accountability.	

Source: Preliminary Report Malaysia Education Blueprint 2013-2025.

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