SME SENTIMENT INDEX 1H 2024

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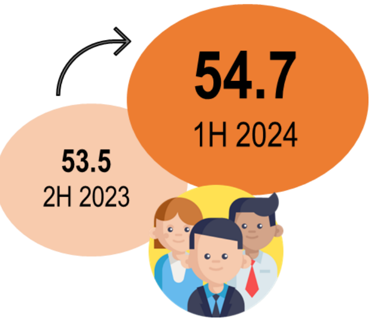
SME Bank has carried out SME Sentiment Index 1H 2024 survey between January and April 2024 which has successfully amassed responses from 1,295 participants, representing various sectors and business sizes. As a leading economic indicator, this Index serves to gauge Micro, Small and Medium-sized Enterprises (MSMEs)'s view of the business environment which can be the yardstick in measuring how the overall economy is expected to behave.

The **Index has climbed up to 54.7** (2H 2023: 53.5), mainly contributed by an improving score for **economic expectation, better cashflow** and **liquidity buffers**. This reflects optimism, resiliency, and adaptiveness among MSMEs in line with the country's steady economic recovery where GDP growth is forecasted to clock in between 4% to 5% in 2024 (2023: 3.6%). Malaysia's economy expanded 4.2% YoY in 1Q 2024, outperforming consensus (3.9%) and previous quarter (2.9%) as forward-looking indicators including MIER consumer sentiment index, Department of Statistics Malaysia (DOSM)'s business tendency statistics (business expectation) as well as its leading index all point towards continuous economic growth. That said, survey results signal **some concerns regarding profitability, employment decisions** and **expansion plans**, amid a backdrop of **high-cost environment**.

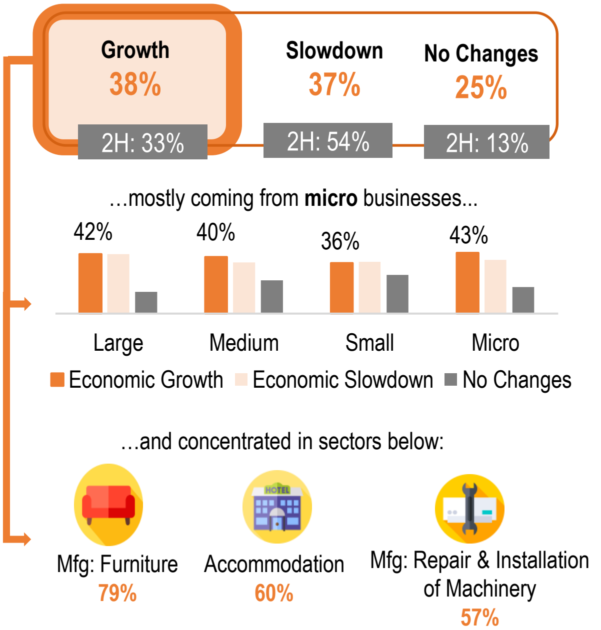


Challenging but better economic expectation among MSMEs

Compared to the previous survey in 2H 2023, MSMEs now have a **more balanced view** on how the economy is going to perform in the next 6 to 12 months. **38% of respondents (2H 2023: 33%) expect an expansion** while 37% (2H 2023: 54%) anticipate a slowdown. Better growth expectation likely stems from 1) solid household spending supported by tight labor market, government's cash aid, EPF account 3 withdrawal, civil servant's salary revision and debt financing; 2) stronger investment activities; and 3) continued recovery on the external front that will lift exports and tourism industry.

The most optimistic sector is the manufacture of furniture where 79% of the respondents expect better growth ahead. Exports of Malaysia's furniture have increased by 18.1% YoY in 1Q 2024 (4Q 2023: 11.9%), the second quarter of consecutive growth. Prior to that, this sector has been contracting since 4Q 2022 (-20.1% YoY). By country, the US accounted for 45% of our total furniture export in 1Q 2024, followed by Singapore (10%) and Japan (6.1%). Although Malaysia's furniture export only contributes 0.9% to total exports, our manufacturing PMI which rose to 50.2 in May (April: 49.0) signals **a rise in factory activity as output returned to growth.** This was underpinned by **expansion in new orders, as export orders rose the most in over 3 years.**

Figure 1: More balanced economic outlook



Accommodation sector is also one of the top sectors which **foresee a growing economy**, indicated by 60% of respondents in this round's survey compared to 40% in 2H 2023. Besides buoyant domestic tourism activities, further improvement in international passenger traffic at Malaysian airports to 87.9% of 2019's pre-pandemic level in 1Q 2024 (4Q 2023: 81.5%) bodes well for the accommodation sector. The recent shift in the composition of foreign tourist arrivals from ASEAN (2023: 73% of total tourist arrival; 2022: 81%), towards China (2023: 7.3%; 2022: 2.1%) demonstrates effort by the government (visa-free entry up to 30 days) and airlines (increased number of direct flights) in the lead up to Visit Malaysia 2026.

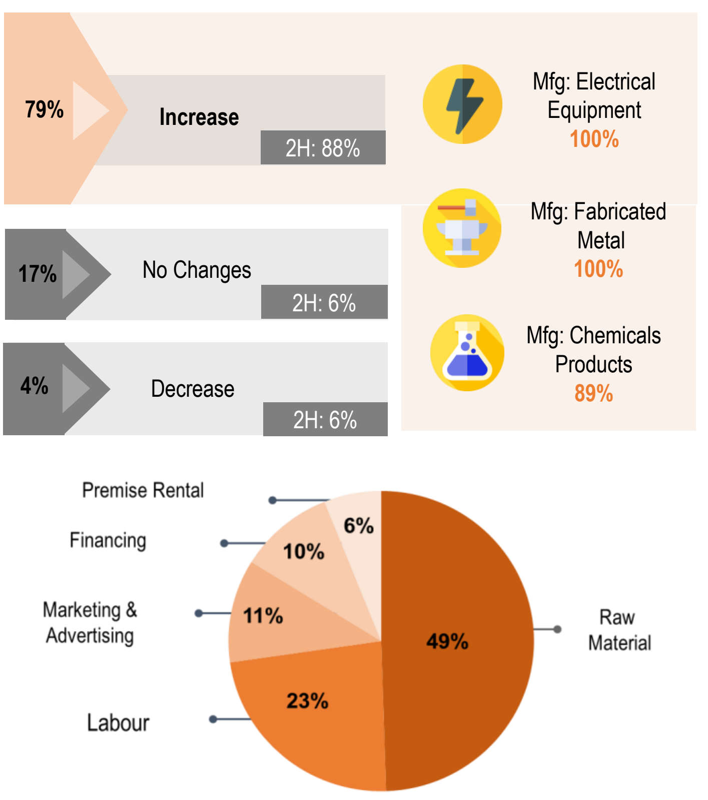
Note: All figures are rounded; they might not add up to 100%.

By business size, expectations are rather mixed as **most of the respondents from micro (43%) and medium (40%) sized businesses foresee the economy to chart a better growth trajectory** while those of small sized businesses feel differently. Among states, **Sarawak (70%) is the most optimistic**, given a magnitude of government projects as well as incoming private investment. For 2024, Sarawak state government allocated RM9 bil for development projects on top of federal government's allocation of RM5.8 bil for the state, totaling approximately 10% of Sarawak's 2023 GDP. Besides that, Sarawak's total approved investment more than doubled to RM21.3 bil in 2023 (average 2017-2019: RM9.4 bil), significantly above the national median of RM9.3 bil

Economies of scale does not necessarily mean lower cost

While most of the respondents (53%) anticipate **higher revenue in the next 6 to 12 months**, it is **lower than the 66% recorded previously**. This highlights challenges faced by MSMEs such as stiffer competition and higher-cost environment. **Majority of the respondents in all business sizes foresee their sales to increase** except small sized businesses, similar to the broader economic outlook. By sector, higher sales expectations came mainly from the manufacture of chemicals and chemical products (78%), followed by accommodation (69%) and manufacture of food products (68%). By state, MSMEs in **Sarawak (89%) and Sabah (75%) registered the highest optimism** where 100% of construction respondents are confident of their revenue generation, in line with both states' sturdy development progress.

Figure 2: High business cost, mainly raw materials



High cost of doing business (79% of respondents) remain a key factor shaping business performance in the near term albeit **better sentiment** vis-à-vis 2H 2023 (88%). **Raw materials (49%) has been cited as the largest cost contributor**, followed distantly by cost of labour (23%), marketing and advertising (11%), financing (10%) and premise rental (6%).

Bigger size businesses seem to feel the pinch the most – reflected by 92% of respondents from large and medium (87%) sized businesses. This could probably be influenced by global spillover events affecting raw materials sourced externally and higher shipping costs, alongside government's reform measures. History shows that when subsidy rationalisation happens, prices will increase temporarily but shall normalise thereafter as consumers and businesses adjust. On the other hand, a comparatively **lower number of respondents from the small (78%) and micro (73%) sized categories expect a rise in cost of doing business, likely because government support measures are available to help cushion near-term impact.**

By sector, all respondents in the manufacture of 1) electrical equipment, and 2) fabricated metal products except machinery and equipment, foresee costs to increase. Although the **overall services (78%) sector seems to be the least perturbed**, a significant number of respondents in some services subsectors expect a rise in cost pressures namely, administrative and support service activities (83%), F&B (81%) and human health activities (80%). More than 70% of respondents in all states foresee costs to increase in the coming months, with Perlis (95%), Pahang (95%) and Sarawak (90%) taking the lead. While raw material contributed the most to rising cost expectation in both Perlis (71%) and Melaka (67%), entrepreneurs in Sarawak (32%) and Perak (35%) are more concerned about rising labour cost.

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MSMEs are largely domestic oriented

Given the Twelfth Malaysia Plan (12MP)'s target for MSMEs to contribute 25.0% to the nation's export by 2025 (2022: 10.5%), we introduced additional questions on MSMEs' exposure to foreign markets in this 1H 2024 survey. Based on our findings, **only 8% of respondents export their goods and services to foreign countries** while the majority (92%) sells them locally. MSMEs' degree of exposure to international markets correspond to their size of business, where almost one fifth of large sized businesses have sales overseas, while only 2% of micro enterprises do so on the other spectrum.

Figure 3: Only 8% of MSMEs export

Sell products to:

Local	Foreign
92%	8%

Top Exporter		
Mfg: Rubber & Plastics 59%	Mfg: Furniture 47%	Mfg: Fabricated Metal 33%

By sector, export activities are mainly concentrated in the manufacturing sector, primarily in rubber and plastic products (59%), furniture (47%) and fabricated metal products, except machinery and equipment (33%). This is in line with **national MSMEs data** published by DOSM where **79% of MSMEs' exports in 2022 were from the manufacturing sector.** It is worth noting that prior to the pandemic (between 2015 – 2019), MSMEs' share of manufacturing exports were less than 50%. Although MSMEs' export in 2022 has recovered to 82% of 2019's level, its export share to total exports has been on a declining trend since 2019 (18%), with the latest share at 10% in 2022.

In terms of imports, 20% of respondents rely on raw materials sourced overseas, predominantly large sized businesses. With greater access to capital and economies of scale, larger companies have more options and could purchase bulk orders from abroad. Notably, **Ringgit depreciation will be more of a concern rather than benefit to MSMEs overall as there is a greater proportion of MSME importers than exporters.** Top sectors with the highest dependency on imported inputs are manufacture of electrical equipment (60%), repair and installation of machinery and equipment (57%) and agriculture (53%). Currency risk can be managed and mitigated via hedging, future contracts, and contract markup etc.

Figure 4: Impact of currency depreciation limited as 80% of MSMEs source their raw materials locally

Buy raw materials from:

Local	Foreign
80%	20%

Top Importer		
Mfg: Electrical Equipment 60%	Mfg: Repair & Installation of Machinery 57%	Agriculture 53%

Confident on future prospects as businesses shift towards permanent hiring

Figure 5: Top 3 sectors that are eager to hire

Mfg: Chemicals Product 78%	Mfg: Electrical Equipment 60%	Mfg: Wearing Apparels 60%

On hiring decisions, **most MSMEs (55%) choose to maintain their current workforce**, which is a total shift compared to previous survey where 67% of respondents plan to hire. This indicates that most businesses may have already expanded their workforce and have reached their optimal level. However, manufacture of chemicals (1H 2024: 78%; 2H 2023: 83%) continue to emerge as the top sector that has intention to hire, followed by manufacture of electrical equipment (60%) and wearing apparels (60%).

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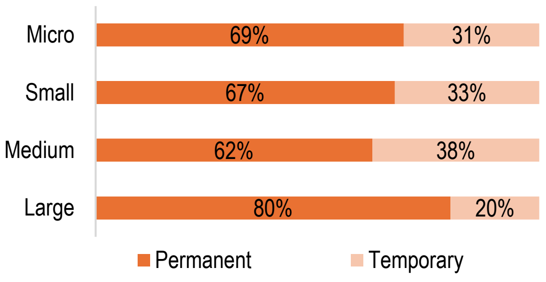
Figure 6: Shift in preference towards hiring permanent workers



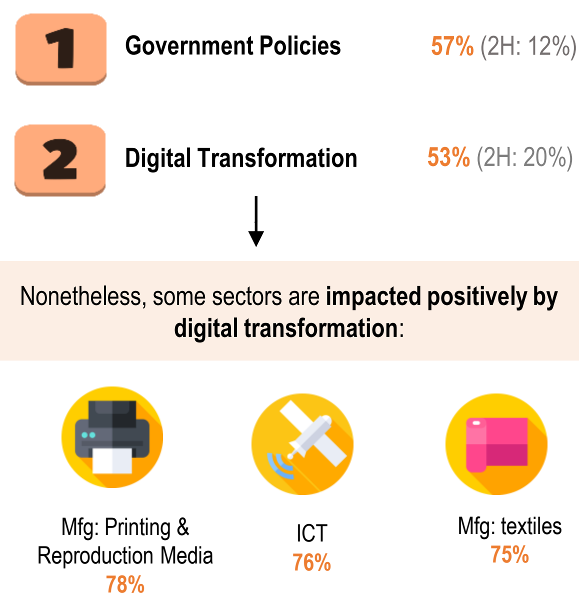
Rising costs could be a factor influencing businesses' decision to maintain their workforce at status quo. Based on the National Wage Consultative Council Act 2011, the minimum wage rate will be reviewed later this year. Additionally, the recent hike in service tax rate and its wider scope may have caused fees of employment agency and job advertisement to climb.

By employment contract, there is **a significant shift across all business sizes towards preference for permanent workers**. This suggests a desire for long-term employment commitments, a stable workforce to maintain productivity and to minimise risks associated with high turnover rates, in line with stabilising economic performance.

MSMEs more cautious on cost related initiatives

Slightly more than half of MSMEs (57%) have responded that they **are neutral towards changes in government policies** such as implementation of targeted subsidy, political uncertainty, or regulatory requirements like ESG adherence, tax compliance and labour law. It is commendable for the government to space out its structural reform agenda such as minimum wages, subsidy rationalisation of chicken and diesel, electricity and water tariff revisions as well as the upcoming implementation of e-invoicing through a sequenced approach. Although these **reforms are highly unpopular, they are crucial for the overall economy in the longer term.** To minimise adverse effects of reforms in the interim, the government has provided exemptions and cash assistance to certain sectors and individuals.

Figure 7: MSMEs are neutral towards changes in government policies and digital transformation



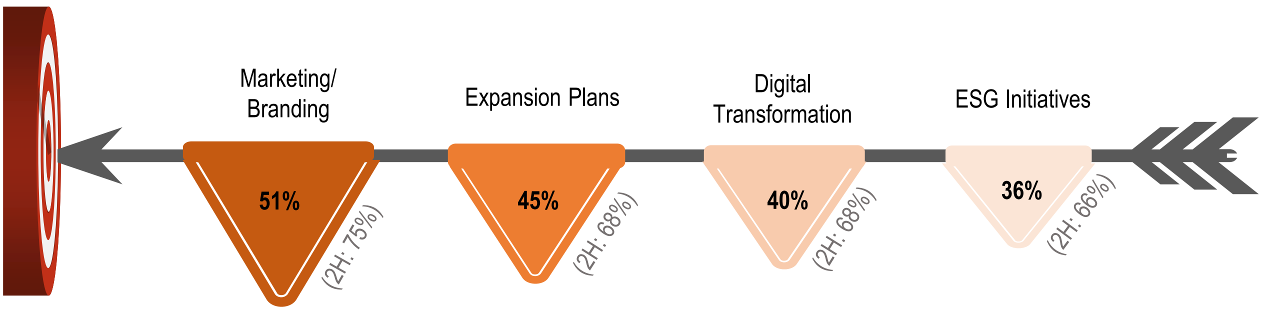
In terms of **digital transformation**, most MSMEs (53%) also view it to be of **neutral impact to their businesses**. This is **contrary to the previous survey** where 80% of respondents believed that it had positive impact. Most of them may have already undertaken the basic and necessary digital transformation such as cashless transactions and online marketing for their business continuity purposes, hence any additional development is deemed to be less significant. Likewise, 58% of MSMEs have no plans to focus on digital transformation. Nonetheless, **sectors that are highly related to technology** such as manufacture of printing and reproduction of recorded media and information and communication (ICT) still view **digital transformation to have positive impact** and wish to focus on improving it, as it directly aligns with their core business. These sectors are usually **early adopters and innovators, benefiting from increased operational efficiency and new revenue opportunities.**

Notwithstanding better economic performance, we gather that **businesses are being more cautious and concerned about sustaining their operations** in this round's survey. While there is a declining focus in expansion plans, digital transformation and ESG initiatives, **marketing remains the top priority for many businesses** (51%) in the next 6 to 12 months as it is important to maintain and nurture customer relationships.

Note: All figures are rounded; they might not add up to 100%.

Even so, the focus on marketing/branding activities have moderated from previous surveys (1H 2024: 51%; 2H 2023: 75%; 1H 2023: 87%) probably due to the cheaper nature of online marketing via social media platforms. In fact, **only 11% of MSMEs foresee the cost of marketing and advertising to go up.** The top three sectors that wish to focus on improving their marketing strategies are warehousing and support activities for transportation (74%), mining and quarrying (71%) and accommodation (67%). **High competition may have pushed the need for marketing to attract customers.** For instance, the number of hotels in Malaysia has been trending upwards in the recent quarters (1Q 2024: 3,543 units; 4Q 2023: 3,538; 3Q: 3,520).

Figure 8: Majority of respondents wish to focus on improving their branding as well as marketing strategies…



More than half of MSMEs have no expansion (51%) plans. Those who have expansion plans are concentrated in the manufacture of electrical equipment (100%), manufacture of textiles (100%) and mining and quarrying (86%). These sectors are also looking to increase hiring concurrently as they expect sales to rise. The resumption in oil and gas production – following the shut down for maintenance last year – is in line with the 6.0% YoY expansion of mining industrial production index (IPI) in 1Q 2024 (4Q 2023: 3.7%; 3Q: -1.5%).

Figure 9: …which applies across all business sizes, led by large firms

Business Size/ Focus	Large	Medium	Small	Micro
Expansion Plans	69%	55%	39%	53%
Digital Transformation	69%	48%	34%	52%
Marketing/ Branding	**84%**	**59%**	**45%**	**60%**
ESG Initiatives	54%	47%	29%	47%

MSMEs have indicated least emphasis (36%) regarding Environmental, Social, and Governance (ESG), a sharp drop from 2H 2023 (77%). **Businesses generally view ESG as cost rather than investment** which may prompt them to push it to the bottom of their priorities. Business survival is key, which is why only **large businesses** – with 54% of respondents – **plan to focus on ESG in the near term** due to regulatory compliance and reputational risks. Some sectors that show interest in increasing ESG practices are manufacture of chemicals products (56%), warehousing and support activities for transportation (53%) and manufacture of rubber and plastics (50%). Interestingly, **ESG related businesses such as the solar industry has shown robust demand for capital**, as SME financing growth at the industry level i.e electricity, gas, steam & air conditioner supply had doubled to 19.8% YoY in 4Q 2023 (3Q: 7.2%).

Figure 10: Large businesses focus on ESG

Note: All figures are rounded; they might not add up to 100%.

Remarkable improvement in financial sustainability

MSMEs have exhibited a significant improvement in their cash flow since the previous survey. The proportion of respondents (72%) with a cash buffer exceeding one year has doubled (2H 2023: 36%), **led by small and medium sized businesses**. Such a reversal in trend could be due to accumulated business profit or financing disbursements – disbursements to the SME industry jumped 12.1% YoY in 4Q 2023 (3Q: 5.8%), driven by the ICT (63.7% YoY), real estate (39.3%) and education (33.9%) sectors.

In this latest survey, 100% of respondents in 8 sectors have cash reserves above 6 months. Namely, 1) accommodation; 2) manufacture of basic metals; 3) manufacture of electrical equipment; 4) manufacture of fabricated metal products, except machinery and equipment; 5) manufacture of rubber and plastics products; 6) manufacture of printing and reproduction of recorded media; 7) manufacture of textiles, and 8) mining and quarrying.

Figure 12: Top 3 vulnerable sectors with less than 6 months of cash reserves:

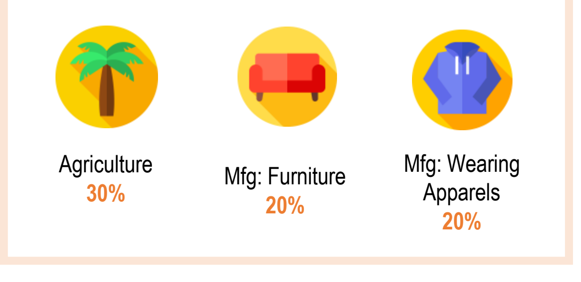


Figure 13: In the event of low cash buffer, MSMEs will resort to:

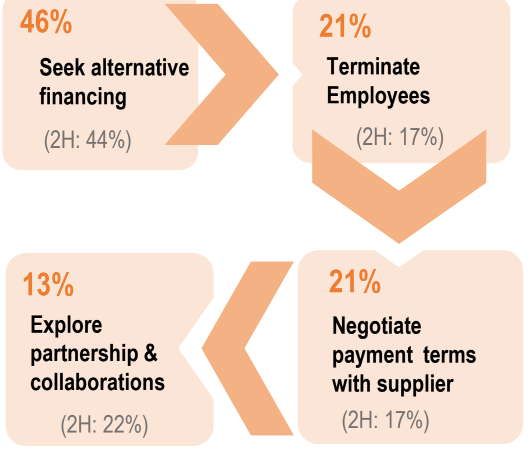
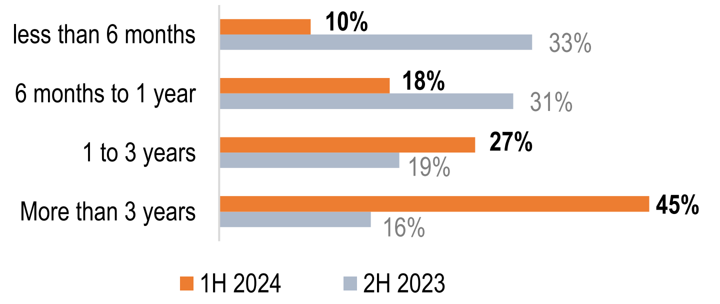


Figure 11: Better cashflow and liquidity buffers



100% respondents from these sectors have **cash reserves above 6 months:**

On the contrary, about a quarter of respondents now (2H 2023: 64%) possess less than a year of cash reserves, where **only 10% have less than 6 months** (2H 2023: 33%), especially MSMEs from the agriculture, manufacture of furniture and manufacture of wearing apparel. Among the MSMEs that have less than 6 months of cash buffer, the **option for financing remains their first choice** (1H 2024: 46%; 2H 2023: 44%) to sustain their business. This corresponds to financing appetite by SMEs at the national level where **overall outstanding SME financing grew by 8.2% YoY in 4Q 2023** (3Q 2023: 5.4%). Apart from financing, 21% of respondents prefer to negotiate payment terms with suppliers in the event of insufficient cash reserves, while the rest would choose to terminate employees and explore partnerships or collaborations.

From our current survey, the top 3 sectors that have indicated needs for financing are professional, scientific and technical activities (75%), manufacture of food products (73%) and food & beverage services (73%). **Although overall financing performance is still healthy, higher cash reserves coupled with less appetite for expansions may dampen future needs and additional demand for financing.**

Note: All figures are rounded; they might not add up to 100%.

Overall, we remain confident that **MSMEs are resilient as they ride through economic cycles and emerge from both domestic and external challenges**. Regular assessment of their business operations and strategies to adapt to new trends and business dynamics are essential to fulfill the changing needs of consumers. Below are funding programs provided by SME Bank as well as trainings by our subsidiary, CEDAR.

Table 1: SME Bank financing programs

- BizCashPlus
- Contract Financing (CF)
- Dana Kemampanan PMKS Bumiputera (DKPB 2.0)
- Dana Pemantapan Automasi (PMG)
- HalalBiz Financing Program (HalalBiz)
- High Tech & Green Facility (HTG)
- Jaguh Serantau (JS)
- Low Carbon Transition Facility (LCTF)
- PENJANA Tourism Financing
- Skim Anjakan Usahawan (i-SMART)
- SME Technology Transformation Fund (STTF)
- Social Enterprise Financing Scheme (SEFS)
- Tabung Khas Pelancongan (TKP)

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Table 2: CEDAR entrepreneur development programmes

- Business Advisory
- Business Exporter Program 2.0
- Customized Grow! Coaching
- ECOTHON 2023
- HRD Corp Signature Programmes-Credit Securing Strategies
- I-Smart
- Mandatory Training Programme
- MDEC 100 Go Digital Accelerator Programme
- Program New Gen (N-Gene) Entrepreneur Online Bootcamp 3.0
- Program Usahawan Perantis (SPACE)
- Skim Insentif Kelestarian
- Skim Juara Lestari
- TITAN Program
- Upward Migration Programme

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