

Zeti Akhtar Aziz: Reflections on small and medium sized enterprises

Keynote address by Dr Zeti Akhtar Aziz, Governor of the Central Bank of Malaysia, at the 7th Conference of Asia-Pacific Economic Cooperation (APEC) Financial Institutions Dealing with SMEs, Lanai Kijang, 16 July 2010.

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Introduction

This conference takes place at a time of great consequence for the financial industry as the world emerges from the recent global financial and economic crisis. Attention continues to be focused on supporting this recovery process and to provide more permanent solutions that would ensure sustainable global growth. In relation to this, the development of small and medium sized enterprises (SMEs) is an important and urgent agenda. For emerging economies, in particular in the APEC region, this is not only important as a driver of the economic growth process but also that it would achieve a more balanced growth. It is my pleasure to be here this morning to speak at this 7th Conference of APEC Financial Institutions Dealing with SMEs, that is organised by the Association of Banks in Malaysia.

History has shown that in the 20th century, it was large corporations that drove economic progress; particularly in the industrial economies. In this century, there is a discernible shift towards the increased importance of SMEs as drivers of growth. The growing importance of domestic demand and the emergence of new sources of growth and new business models have encouraged the emergence of small and medium size businesses. This trend is particularly pronounced in the APEC economies in which the economic activities are now more diversified – with the growing importance of the services sector, with the agricultural sector becoming more advanced and the industrial sector being supported by a supply chain of small and medium scale businesses.

In the APEC region, SMEs account for 90% of the total business establishments and 60% of total employment. In Malaysia, SMEs constitute 99% of all businesses and 57% of total employment. In terms of output, the SME sector in Malaysia accounts for 35% of gross domestic product and 20% of total exports. The SMEs have the advantage of having greater flexibility and the ability to adjust more quickly to changes in the market. The SMEs also have the potential to meet the new challenges to raise productivity and performance. There is therefore enormous potential for SMEs to create significant positive value for the economy, and thus contribute towards sustainable and balanced economic growth, employment and social stability.

This morning allow me to take this opportunity to share with you some reflections on SMEs in the more globalised economy, and the role of financial institutions and Governments in supporting the SME sector in the future environment.

Prospects for SMEs in a more globalised economy

Globalisation has been described as one of the defining changes of the 21st century. More importantly perhaps, is the dramatic change in the nature of the globalization process. The initial wave of globalization was in the form of trade, and this was followed by the globalization of corporations. More recently the globalization of financial flows and in the flow of talent that follow increase in capital and labour mobility across borders. Indeed there has been a shift from the domestic sphere to a greater global orientation. This is evident in the stronger trends in international trade, foreign direct investment, international capital flows, and movement in labour across borders. Greater connectivity enabled by technological advancements have also significantly increased the pace of globalisation to an extent that was previously not possible.

For SMEs, gaining access to the expanding global market is a strategic step forward that would bring tremendous business opportunities. It would enhance the possibilities to exploit economies of scale and scope of the business, and the potential for enhanced technological capabilities and greater risk diversification. The globalised economy will, however, challenge existing comparative advantages and thus drive the search for new business models to sustain competitiveness. The SMEs in this new environment need to evaluate new markets, move to higher value-added products and services, and develop new synergies by forging new business alliances, acquisitions or partnerships.

Given the important socio-economic contribution of SMEs to national economies, promoting an increased participation of SMEs in both domestic economy and international markets has become an important agenda in most emerging economies as part of the efforts to enhance the overall economic growth potential. Today, while SMEs are growing in significance in most emerging economies, SMEs remain under-represented in international trade, accounting for only one quarter to one third of manufactured exports and a very small share of foreign direct investment. By comparison, SMEs in the developed economies contribute about 50% of total value added.

For SMEs that become increasingly knowledge based and technologically advanced, the opportunities exist to participate in international strategic alliances, to connect into global and regional supply chains, and to be part of a production network. These arrangements will require a transformation of existing business models, management and technological capability, and the innovative capacity of the SMEs. It will need to involve increased access to financial resources, collective research efforts, accelerated product development and wider distribution channels.

The ability of SMEs to realise this potential depends critically on providing the necessary infrastructure and enabling environment for SMEs to enhance their capacity and capability to effectively participate and expand in the domestic economy and to venture into the international markets. The financial sector and Government support are an essential part of this enabling environment for SME development.

Repositioning of the financial industry to meet the new demands of SMEs

Banks are the dominant providers of financial services to SMEs. In the recent period, considerable advances have been made among APEC economies towards strengthening the scope and access to financial services to the SMEs. The financial sector has become more broad based, competitive and efficient in providing entrepreneurs with alternative sources of investment capital, a diversified selection of new and innovative products, competitive rates, and more efficient services. This has been accompanied by increased ancillary support services including business advisory services. These mutually complementary elements are in addition to access, choice of products, pricing and the quality of services to the SMEs.

The more globalised environment however, requires new approaches and paradigm shifts are required for SME financing. First, there needs to be a recognition that SMEs are going to be increasingly specialized and diversified. Therefore, the traditional standard transactional and lending-based banking approach needs to shift towards more customized and differentiated financial products and services that are tailored to the size, profile and specific needs of the different SMEs. This in turn, requires a different approach in the way financial institutions manage their relationships with SMEs. As SMEs become more innovative and entrepreneurial, financial institutions will need to be able to form sound judgments about the business of the SMEs based on a broader range of credit information which go beyond the narrow traditional focus on collateral and historical financial information.

Second, SMEs are likely to see a more pronounced shift towards more innovative and creative industries, such as green technology, medical sciences, information technology and computer animation. In such knowledge-based industries, the true value of companies is not

measured in tangible assets, but in intellectual capital and specialist skills. Therefore, financial institutions will need to deepen their understanding of these new growth industries, and build capacity to evaluate and manage the associated and related risks.

Third, with the increasing adoption of e-commerce applications by SMEs such as internet and mobile banking, financial institutions can also encourage the deployment of technological capabilities to the SME's business operations. This can include working with SMEs to provide end-to-end supply chain management solutions and the expansion into regional production networks. Such support for the growth of SMEs can bring substantial benefits to financial institutions as SMEs evolve into larger corporations.

Role of the government

While the economy is powered by private initiatives, Governments have a critical role in providing an enabling environment for private enterprises to thrive. In most economies which have a successful SME sector, the Government has had a major role in coordinating the support and in strengthening the capacity of SMEs and providing an enabling environment for SMEs to thrive. In Malaysia, a comprehensive approach has been adopted by the Government. In 2004, the National SME Development Council (NSDC) was established by the Government to formulate broad policies and strategies aimed at creating an enabling environment for the comprehensive development of SMEs across all sectors. The Council, Chaired by the Prime Minister is the highest policy making body for SME development in Malaysia and brings together more than 15 ministries and 60 agencies under a coordinated national strategy. To implement the policies of the Council, the SME Corporation Malaysia (SME Corp), a specialised government agency, was established in October 2009 to ensure the effective implementation of SME development programs under three broad strategic thrusts: strengthening the enabling infrastructure, enhancing capacity and capability of SMEs and enhancing access to financing. For the year 2010, a total of 354 programs, with a financial commitment of RM6.02 billion is being implemented to develop high performance and resilient SMEs.

To strengthen the financial infrastructure for SMEs, Bank Negara Malaysia has implemented wide ranging measures. The restructuring and consolidation of the banking sector following the Asian financial crisis as well as the financial reforms and capacity building efforts taken over the years, including enhancing corporate governance and strengthening risk management practices, had strengthened their capacity to provide more diversified financial services to SMEs. The deregulation of the financial sector including the new interest rate framework allowed for flexible pricing to reflect the risks and it also promoted increased competition in the financial system. Encouraging banking institutions to establish advisory units to support SMEs also reinforced increased access to financing. These have been reinforced by the establishment of the Credit Guarantee Corporation to provide credit guarantees to SMEs to facilitate their access to financing from financial institutions. An SME Credit Bureau and the Central Credit Reference Information System (CCRIS) complements the infrastructure that is in place for SME financing by collating vital credit and transaction information that enable SMEs to build their credit reputation from a wide range of informational sources.

The Bank also continues to actively reach out to support SMEs through the provision of financial planning and risk management services, and the promotion of financial literacy alongside similar initiatives by financial institutions. Public-private partnerships between The Association of Banks in Malaysia and Bank Negara Malaysia have also worked successfully to encourage improvements in customer service levels and the turn-around time taken to process SME financing applications. These initiatives have yielded tremendous payoffs to the national economy. Malaysia also ranked in first place in the world in 2009 in the category of access to credit by the World Bank in their "Doing Business 2010 Report".

International and regional cooperation

In a global economy, efforts to support SMEs must also address frameworks for facilitating trade, payments and financing beyond national borders. Effective regional and international collaboration can add significantly to enhance further the long term contribution of SMEs to the economy. The endeavour by APEC in the establishment of the APEC SME Working Group in 1995 has provided an important collaborative platform for policymakers and private sector leaders to come together in designing regional strategies for SME development. Under this working group, policies have been developed to improve the business environment for SMEs, build SME management capabilities, enhance access to markets, promote innovation, enhance access to financing and encourage sustainable business practices. Successful projects implemented in 2009 include the replication of business counselor training programmes across the region and the development of strategies for enhancing the competitiveness of small trading houses and exporters. Under the Memorandum of Understanding entered into by various APEC financial institutions dealing with SMEs in 2003, many more financial institutions have benefitted from increased trade facilitation, transfer of knowledge, expanded cross-border growth opportunities and information sharing.

Conclusion

Let me conclude my remarks. The importance of SMEs in APEC economies is clear. However, while their large numbers make them important to the economy, it is their potential that places them at the centre of the economic transformation agenda. Support for SME development requires cohesive and cross-cutting strategies which encompasses the collective efforts of the financial sector, the Governments and SMEs themselves. In the global economy, common strategies that are well coordinated across borders would facilitate the participation of SMEs in the globalisation process. The ultimate goal is to promote entrepreneurship and develop an environment favourable to SMEs that will allow them to become more competitive in both the domestic and international markets.

In closing, I would like to congratulate the Association of Banks Malaysia for hosting this event and encouraging wider international dialogue on important developments affecting SMEs. I wish you a productive and successful Conference.