

SME Policies of Malaysian Government: A Historical and Functional Examination

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1. Introduction

This paper reviews the Malaysian government's Small and Medium Enterprise (SME¹⁾) policy from a historical perspective. Foreign flagship companies made a tremendous contribution to Malaysia's export-oriented electrical and electronics (E&E) industrialisation. By creating free trade zones (FTZs) and providing effective investment incentives, government policy was highly successful in attracting foreign companies, making Malaysia one of the world's largest semiconductor producers in the 1980s. However, after the impressive initial success of Malaysia's export-oriented industrialisation, it was gradually recognised that, in order to reap the full benefits to the economy, the creation of backward linkages between large electronics companies and local component and material suppliers was of critical importance – and is the central concern of this paper. Local SMEs were expected to play an integral role in linkage creation: how much did the government's SME support policies help them to do so?

In theory, if markets worked efficiently they would automatically generate an optimal size distribution of firms, and no government intervention would be needed. However, in real-world free market economies, smaller firms tend to be at a disadvantage vis-a-vis larger firms in market competition and in obtaining finance, labour, technology, and information (Smallbone 2000, Bennett 2014). This is a form of “market failure,” in which large firms enjoy economies of scale that allow them to dominate SMEs, whose difficulties

1) SMI (Small and Medium Industry), a concept similar to SME, also appeared widely, particularly in the early writings of Malaysian government and researchers. The terms SMI and SME were often used interchangeably, but the implication is slightly different. According to Karikomi (1998) and Ndubisi & Saleh (2006), SMI is more limited, referring to the manufacturing sectors, while SME encompasses various sectors including services, construction, ICT, and other economic activities. Although my focus is the manufacturing sector, I have used only the term SME in this paper.

are intensified in the environment of a developing economy where there are more obstacles to markets functioning efficiently (Schmitz 1982, Little et al. 1987, Tambunan 2009). To compensate for these disadvantages, appropriate government support to SMEs is justified (Storey 1994, Smallbone 2000).

Malaysia's SME support policies are often seen as relatively successful (Meyanathan & Salleh 1994, Moha Asri 1999a, Hashim 1999, Ndubisi 2008a). Statistically, for example, the contribution of Malaysian SMEs to total national value-added was reported as 47.3% in 2005, higher than that of other Asian economies such as Thailand (38.9%), Singapore (34.7%) and the Philippines (32.0%), although lower than that of Indonesia (57.0%) and China (60.0%) (Ndubisi 2008b, 25). Some credit must be given to SME support policies. Malaysia pursued a laissez-faire development policy during the colonial period and in the 1960s after independence. During these periods, political emphasis was placed on the development of the traditional resource-based and export-oriented large firms, local and foreign-owned, and the development of local SMEs was left largely to market forces. However, in addition to the incentives offered to large TNCs, various types of support and incentives were gradually introduced to promote local SMEs.

This paper examines the characteristics and history of public assistance to support the development of local SMEs in Malaysia. The following three points will be addressed. First, what are the industrial characteristics of SMEs in Malaysia, as compared with large firms? Second, how did SME policies historically change along with the process of Malaysian industrialisation? Third, what types of measures were, and are, put in place to support the development of local SMEs? The following part of this paper examines these issues.

2. Definition and Characteristics of SMEs in Malaysia

For a long time after independence, there was no single comprehensive definition of SMEs in Malaysia (Moha Asri 1999a, Chin & Lim 2018). Different government agencies used different definitions for different purposes – which in itself is evidence that Malaysia's SME policies were planned and conducted in a rather decentralised manner. A typical example was when the Ministry of International Trade and Industry (MITI) introduced the Industrial Coordination Act (ICA) in 1975. The Act required all manufacturing enterprises to apply for a new license. This regulation applied to enterprises with more than 25 workers and paid-up capital of more than MR250,000 (this limit was raised later). Smaller companies were excluded from this obligation because they were recognised as economically

disadvantaged, and SMEs were implicitly defined as those with 25 or fewer workers.

However, several studies of Malaysia, involving international organisations such as the World Bank (1984), UNIDO (1986), and ADB (1990), adopted the following shared definitions:

- (1) small-scale enterprises – establishments employing less than 50 workers
- (2) medium-scale enterprises – between 50 and 199 workers, and
- (3) large-scale enterprises – more than 200 workers.

These definitions were also adopted by some individual researchers (Chee 1987, Meyanathan & Salleh 1994, Moha Asri 1999a), though other definitions were used—for example, fewer than 100 workers as the threshold of SME classification (Fong 1990). To maximise comparability with earlier empirical research on Malaysia, I too follow these shared definitions and define SMEs as enterprises that employ fewer than 200 workers²⁾.

On this definition, it can be clearly observed that, like many other countries, Malaysia has a manufacturing sector that, numerically, has long been overwhelmingly made up of SMEs. Table 1 shows that, in 1981 for example, firms employing less than 200 workers accounted for nearly 98 percent of all enterprises in Malaysia's manufacturing sector. However, SMEs only employed 55 percent of the total workforce and accounted for only 47 percent of the total value-added. Over the next 20 years, moreover, SME shares of employment, output, and value-added declined, implying that in Malaysia, large firms expanded more rapidly in all aspects of manufacturing activities than SMEs did³⁾.

2) Obviously, for practical purposes, having no unified definition of SMEs creates difficulties when it comes to formulating and implementing effective SME support policies consistently among different government bodies. To overcome this problem, on 9 June 2005, the National SME Development Council (NSDC), the highest policy-making body for facilitating the development of SMEs, approved the legal definition of Malaysian SMEs across the economic sectors as follows (Bank Negara Malaysia 2005, Ndubisi 2008a, Chin & Lim 2018):

(1) Manufacturing, manufacturing-related services and agro-based industries:

Full-time employees not exceeding 150, or Annual sales turnover not exceeding RM25 million

(2) Service, primary agriculture, and Information and Communications Technology (ICT) companies:

Full-time employees not exceeding 50, or annual sales turnover not exceeding RM5 million

This definition has been adopted by all Government Ministries and Agencies in SME development. It is slightly different from the definition I have adopted in this paper.

3) It is possible to interpret these figures in a different way. Employment in some SMEs may have increased enough to push them into the category of large firms. From simply analysing these tables, it is impossible to infer to what extent this happened, but it is unlikely to have occurred enough to influence the general tendency.

Table 1 Percentage Share of No. of Establishments, Employment, Value of Output and Value-Added by Employment Size of Firms in Malaysian Manufacturing Sector from 1981 to 1999

Establishments (%)	1981	1993	1995	1997	1999
SME (0~199)	97.8	94.8	93.8	91.8	82.7
200 or more	2.2	5.2	6.2	8.2	17.3
TOTAL in No.	20,429	23,462	22,453	23,029	21,891
Employment (%)					
SME (0~199)	55.0	39.4	36.2	33.4	31.0
200 or more	45.0	60.6	63.8	66.6	69.0
TOTAL in No.	567,500	1,266,727	1,389,545	1,411,447	1,358,176
Value of Output (%)					
SME (0~199)	n.a.	32.4	29.7	27.6	24.2
200 or more	n.a.	67.6	70.3	72.4	75.8
TOTAL in RM mil.	n.a.	167,974	246,923	297,130	361,389
Value Added (%)					
SME (0~199)	46.9	31.0	28.8	25.1	24.9
200 or more	53.1	69.0	71.2	74.9	75.1
TOTAL in RM mil.	4,774	44,207	59,629	79,173	87,790

(Source) JICA (2003), originally from Department of Statistics (DOS) Malaysia (various issues)

A second striking feature of Malaysian SME development is their skewed distribution across industries. Traditionally, most Malaysian SMEs were in sectors which tended to be labour-intensive, less-skilled, and domestic-market oriented (Meyanathan & Salleh 1994, 26). Table 2 shows the sectoral distribution of SMEs and large firms by industry in 1981 – at the initial stage of Malaysian manufacturing industrialisation. As can be seen from this table, SMEs accounted for extremely high percentages of firms in fabricated metal (99.6%); machinery (99.3%); food products (98.2%); wood products (98.1%); base metal (97.9%); and chemical products (97.9%). Plastic parts (which are included under chemical products in Table 2) and metal products are the central focus of my research. These products are important for supporting E&E industrialisation and they are relatively easy for local TNCs to outsource.

Large firms were most frequently found in the electrical/electronics sector; their share of 21.8% in number of firms and 89.5% of value-added clearly shows their dominance in the EE industries. Thus, a dualistic industrial structure is observed, with large EE firms being supported by many SMEs that supply them with plastic and metal parts. For this reason, SME development was critical for further growth of Malaysian EE industries.

Table 2 Malaysia: Distribution of Firms by Size of Employment and by Industry, 1981

Industry	Employment 1-199		Employment 200+		Total	
	No. of firms	V/A share	No. of firms	V/A share	No. of firms	V/A share
Food products	3,142 (98.2)	53.1	56 (1.8)	46.9	3,198 (100)	100
Beverages and tobacco	283 (95.6)	9.9	13 (4.4)	90.1	296 (100)	100
Textile	2,420 (97.2)	24.5	70 (2.8)	75.5	2,490 (100)	100
Wood products	2,784 (98.1)	69.2	53 (1.9)	30.8	2,837 (100)	100
Paper, pulp & printing	939 (97.2)	51.1	27 (2.8)	48.9	966 (100)	100
Chemical products	1,075 (97.9)	58.8	23 (2.1)	41.2	1,098 (100)	100
Petroleum products	14 (93.3)	1.1	1 (6.7)	98.9	15 (100)	100
Rubber products	510 (93.3)	48.7	37 (6.7)	51.3	547 (100)	100
Non-metallic	753 (96.9)	39.5	24 (3.1)	60.5	777 (100)	100
Base metal	413 (97.9)	32.9	9 (2.1)	67.1	422 (100)	100
Fabricated metal	2,384 (99.6)	63.3	10 (0.4)	36.7	2,394 (100)	100
Machinery	1,435 (99.4)	69.8	10 (0.6)	30.2	1,445 (100)	100
Electrical / electronic	244 (78.2)	10.3	68 (21.8)	89.5	312 (100)	100
Transport equipment	317 (94.3)	20.0	19 (5.7)	80.0	336 (100)	100
Other manufacturing	627 (96.9)	28.8	20 (3.1)	71.2	647 (100)	100
Total manufacturing	17,340 (97.5)	38.7	437 (2.5)	61.3	1,778 (100)	100

(Source) Calculated from Meyanathan & Salleh (1994, 58),
originally from Government of Malaysia (1981) DOS, Census of Manufacturing Industries.

A third feature of Malaysian SMEs is the ethnic structure of the country's industrial distribution. Table 3 shows employment and paid-up capital by industry and ethnic group as of the end of 1982, including both SMEs and large enterprises. In terms of paid-up capital, Bumiputera-owned companies were concentrated in domestic-market-oriented and/or low-technology sectors, such as transport equipment (mainly repair work), food processing, and wood production. By contrast, supporting industries for electronics

Table 3 (a) The Structure of Employment of Manufacturing Companies by Industry

(as of 31 Dec 1982)

Industry (No. of firms)	Employment (No. of person)						Employment (percentage to TOTAL)					
	Malaysian					non-Malaysian	Malaysian					non-Malaysian
	Bumiputera	Chinese	Indian	Others	total		Bumiputera	Chinese	Indian	Others	total	
Food products (443)	25,906	14,256	7,156	456	47,774	1,494	49,268	28.9%	14.5%	0.9%	97.0%	3.0%
Beverages and tobacco (54)	3,810	4,073	909	98	8,890	17	8,907	42.8%	10.2%	1.1%	99.8%	0.2%
Textile (255)	26,108	20,560	7,360	347	54,375	352	54,727	47.7%	13.4%	0.6%	99.4%	0.6%
Leather products (21)	1,922	1,184	473	6	3,585	13	3,598	53.4%	13.1%	0.2%	99.6%	0.4%
Wood products (387)	27,076	12,292	3,668	639	43,675	1,293	44,968	60.2%	27.3%	1.4%	97.1%	2.9%
Furniture (44)	1,920	1,005	515	20	3,460	14	3,474	55.3%	28.9%	0.6%	99.6%	0.4%
Paper, pulp, printing (154)	5,315	7,986	2,030	110	15,441	27	15,468	34.4%	51.6%	0.7%	99.8%	0.2%
Chemical products (216)	7,048	5,319	1,899	261	14,527	96	14,623	48.2%	36.4%	1.8%	99.3%	0.7%
Rubber products (112)	9,067	4,844	3,256	137	17,304	92	17,396	52.1%	27.8%	0.8%	99.5%	0.5%
Petroleum products (12)	558	481	223	9	1,271	10	1,281	43.6%	37.5%	0.7%	99.2%	0.8%
Plastic products (180)	5,983	3,802	2,149	109	12,043	40	12,083	49.5%	31.5%	0.9%	99.7%	0.3%
Non-metallic (185)	8,974	4,900	3,714	214	17,802	143	17,945	50.0%	27.3%	1.2%	99.2%	0.8%
Base metal (85)	4,181	4,182	1,464	75	9,902	62	9,964	42.0%	42.0%	0.8%	99.4%	0.6%
Fabricated metal (246)	8,263	6,150	2,831	143	17,387	102	17,489	47.2%	35.2%	0.8%	99.4%	0.6%
Machinery (111)	2,788	3,504	1,034	89	7,415	42	7,457	37.4%	47.0%	1.2%	99.4%	0.6%
Electrical/electronics (186)	46,225	19,705	11,577	578	78,085	267	78,352	59.0%	25.1%	0.7%	99.7%	0.3%
Transport equipment (110)	9,705	5,739	2,443	133	18,020	179	18,199	53.3%	31.5%	0.7%	99.0%	1.0%
Science and testing (16)	1,690	672	618	11	2,991	28	3,019	56.0%	22.3%	0.4%	99.1%	0.9%
Others (61)	4,358	1,543	1,095	52	7,048	78	7,126	61.2%	21.7%	0.7%	98.9%	1.1%
Hotel and travel (62)	6,620	6,073	1,272	465	14,430	181	14,611	45.3%	41.6%	3.2%	98.8%	1.2%
TOTAL (2,940)	207,517	128,270	55,686	3,952	395,425	4,530	399,955	51.9%	32.1%	1.0%	98.9%	1.1%

(Source) Calculated from Yasuda (1988, 154-155), originally from MIDA database.

Table 3 (b) The Structure of Paid-Up Capital of Manufacturing Companies by Industry

(as of 31 Dec 1982)

Industry (No. of firms)	Paid-up Capital (RM 1,000)						Paid-up Capital (percentage to TOTAL)				
	Malaysian						Malaysian				TOTAL
	Bumiputera	Chinese	Indian	Others	Foreigner	TOTAL	Bumiputera	Chinese	Indian	Others	
Food products (443)	558,145	400,869	24,763	308,192	571,218	1,863,187	30.0%	21.5%	1.3%	16.5%	30.7%
Beverages and tobacco (54)	34,621	42,888	1,666	56,928	230,648	366,751	9.4%	11.7%	0.5%	15.5%	62.9%
Textile (255)	110,789	138,032	11,237	88,450	376,107	724,615	15.3%	19.0%	1.6%	12.2%	51.9%
Leather products (21)	10,552	7,469	537	5,308	17,113	40,979	25.7%	18.2%	1.3%	13.0%	41.8%
Wood products (387)	223,369	361,569	3,465	98,288	100,207	786,898	28.4%	45.9%	0.4%	12.5%	100%
Furniture (44)	27,669	21,212	526	39,491	18,872	107,770	25.7%	19.7%	0.5%	36.6%	100%
Paper, pulp, printing (154)	49,873	103,478	1,687	49,003	26,594	230,635	21.6%	44.9%	0.7%	21.2%	100%
Chemical products (216)	105,277	90,594	3,138	73,622	298,117	570,748	18.4%	15.9%	0.5%	12.9%	100%
Rubber products (112)	73,748	68,700	3,599	83,898	95,776	325,721	22.6%	21.1%	1.1%	25.8%	100%
Petroleum products (12)	5,664	6,205	747	5,080	124,504	142,200	4.0%	4.4%	0.5%	3.6%	100%
Plastic products (180)	25,167	101,981	799	23,231	20,708	171,886	14.6%	59.3%	0.5%	13.5%	100%
Non-metallic (185)	151,046	193,307	3,150	214,170	297,323	858,996	17.6%	22.5%	0.4%	24.9%	100%
Base metal (85)	102,292	132,992	7,706	80,675	222,271	545,936	18.7%	24.4%	1.4%	14.8%	100%
Fabricated metal (246)	77,898	201,027	1,797	43,321	123,266	447,309	17.4%	44.9%	0.4%	9.7%	100%
Machinery (111)	19,435	34,630	1,236	39,286	58,797	153,384	12.7%	22.6%	0.8%	25.6%	100%
Electrical/electronics (186)	102,099	76,320	1,340	28,474	320,375	528,608	19.3%	14.4%	0.3%	5.4%	100%
Transport equipment (110)	229,280	67,313	4,012	88,587	166,358	555,550	41.3%	12.1%	0.7%	15.9%	100%
Science and testing (16)	1,456	2,110	42	228	30,728	34,564	4.2%	6.1%	0.1%	0.7%	100%
Others (61)	22,609	10,022	259	4,234	28,690	65,814	34.4%	15.2%	0.4%	6.4%	100%
Hotel and travel (62)	209,733	174,032	1,796	158,238	149,470	693,269	30.3%	25.1%	0.3%	22.8%	100%
Ratio to TOTAL	2,140,722	2,234,750	73,502	1,488,704	3,277,142	9,214,820	23.2%	24.3%	0.8%	16.2%	100%

(Source) Calculated from Yasuda (1988, 154–155), originally from MIDA database.

industrialisation such as plastic, fabricated metal, and base metal were largely controlled by Chinese-Malaysians. Such an ethnically divided industrial structure was an initial economic condition of Malaysia's export-oriented industrialisation, and had significant implications, and created limitations, for future SME support policies.

As described above, the Malaysian manufacturing sector suffered from several structural problems from the viewpoint of SME development. First, although SMEs dominated the Malaysian manufacturing sector in terms of number of firms, their substantive contribution to the national economy—in employment, output, and value-added—has been much smaller and has declined. Second, at the initial stage of Malaysian industrial development, SMEs were of marginal importance, especially in relation to the strategic sectors such as electrical/electronics to which large TNCs made a significant contribution. Third, the distribution of industries was ethnically skewed, with the key sectors supporting export-oriented industrialisation largely controlled by Chinese-Malaysians, while Bumiputera-owned companies were concentrated in domestic-market-oriented sectors, and almost entirely disconnected from exporting industries.

As discussed further below, these features reflect Malaysia's historical industrial policy. Prior to the introduction of NEP, Malaysian SMEs were largely unsupported. Even after the launch of an export-oriented industrialisation strategy, SME development policy remained secondary and marginal. The development of SMEs lagged considerably behind that of large enterprises. It was only after the establishment of the Small and Medium Industries Development Corporation (SMIDEC) in 1996 that a consistent and full-scale SME support policy was planned and implemented in Malaysia – which was after arriving at the mature stage of electronics industrialisation. This timing clearly raises an important question about the contribution and effectiveness of Malaysian SME policy in the creation of linkages between SMEs and large foreign firms. The following section will examine this question from the historical point of view.

3. The Development of Malaysian SME Support Policies

Phase I (1957 – mid 1970s): Scant Support for SMEs

For a decade after independence in 1957, no major government support programmes designed specifically for SMEs were planned or prepared, and until 1970 no specific incentives were provided to SMEs (Fong 1990, 156). The prime objective of the government at this time was relatively easy industrialisation centred on the establishment of large

resource-based enterprises. However, the traditional rubber and tin, and later palm oil, industries gave some stimulation to the development of primitive types of workshops and foundries, especially in the sectors of processing and machinery fabrication and repairs (Thoburn 1977).

During the 1960s, while Malaysia was focussing on resource-based industrialisation, the first SME support programmes were officially mentioned in the First Malaysia Plan (1966–70). However, this SME “support” was largely verbal and lacked substance (Chee 1986). As is clearly indicated by the introduction of the Investment Incentives Act of 1968, the government’s political emphasis was still on nurturing large enterprises by attracting more FDI. However, this stance was modified when the New Economic Policy (NEP) was launched in 1971 in response to the 1969 race riots – and reaffirmed in subsequent five-year National Development Plans. The important role that SMEs played in the Malaysian economy first received political attention in these plans in the sense that development of SMEs was expected to contribute to the economy in modernisation, generating employment and income, and reducing poverty and economic imbalance among different ethnic groups (Meyanathan & Salleh 1994). The government’s attention to SME promotion and programmes was exclusively focused on the development of indigenous, i.e., Bumiputera, entrepreneurs. Several minor SME agencies were set up, such as the Coordinating Council for Development of Small-scale Industries (CCDSI), in order to provide support exclusively to Bumiputera enterprises (Chee 1986).

Phase II (mid 70s – mid 80s): Emphasis on Bumiputera Support

Until the early 1980s, Malaysia’s SME policies were conducted along the lines of the political philosophy embodied in the NEP. The Fourth Malaysia Plan (1981–1985) provided the most comprehensive listing of government guidelines for SME development to that time. These guidelines emphasised, among other things, the following three points (Moha Asri 1999a):

- i) SMEs should not duplicate activities already undertaken by larger-scale enterprises, and preference should be given to SMEs which complement the activities of larger-scale businesses;
- ii) the selection of industries must satisfy the need to achieve the New Economic Policy, particularly in encouraging Bumiputera participation in business and other commercial activities; and
- iii) the promotion of SMEs should be considered an integral part of the overall

development of the manufacturing sector.

These guidelines clearly place SMEs in a complementary position to the development of large firms. At the same time, SMEs were expected to become a major vehicle to improve the economic position of Bumiputera entrepreneurs.

Regarding the development of the institutional framework, an important step was the establishment of the Division of Small Enterprise (DSE) under the MITI in 1981, whose sole responsibility was to look after the interests of Malaysian-owned SMEs. Its fundamental function was to harmonise and coordinate the policies and strategies formerly conducted in an uncoordinated manner by various government agencies involved in SME development. The main functions of this division can be summarised as follows (Hashim 2000):

- i) to study and evaluate the existing and forthcoming policies for the development of SMEs;
- ii) to identify opportunities in industries for involvement of SMEs;
- iii) to provide advice and guidance to entrepreneurs on policies and programmes implemented by government agencies through conferences, dialogues, talks, and workshops;
- iv) to collect and distribute publications on projects, studies, and pamphlets on SMEs; and
- v) to create and implement specific programmes for the development of small firms.

Bumiputera participation was still implicitly stressed in implementing DSE policies.

From the point of view of linkage formation, Malaysian SME policies in the 1970s and early 1980s have two negative implications. First, the policies were basically “inward-looking,” “import substituting,” and “domestic-market oriented,” because they concentrated on promoting Bumiputera enterprises. As is shown in Table 3, the major products of Bumiputera SMEs were processed items such as food, furniture, and miscellaneous goods which mainly served domestic markets or, at best, replaced imported consumer goods under tariff protection. Consequently, the development of Bumiputera SMEs was weakly correlated with the growing presence of foreign affiliates in FTZs. Second, the political emphasis on Bumiputera participation was inconsistent with unleashing the full potential of Malaysian SME development. The Industrial Coordination Act (ICA) of 1975 required local firms (with equity above RM 250,000 or a full-time workforce of more than 24 persons) to comply with Bumiputera ownership and employment targets. This caused a great deal of inconvenience and uncertainty in the investment environment for non-Bumiputera,

particularly Chinese, entrepreneurs, who were the majority of industrial capitalists in Malaysia. Fong (1990) illustrates the importance of non-Bumiputera industrialists by citing the following episode. In 1980, the World Bank provided a loan of US\$100 million to the Malaysian government specifically for the financing of Bumiputera small enterprises. In spite of the numerous incentives that accompanied the loan, however, Bumiputera entrepreneurs were slow and few to respond; as a result, only ten percent of the financing target was achieved by 1986. The requirements then had to be relaxed to allow non-Bumiputera SMEs to apply so that full use could be made of the fund (Fong 1990, 158).

Phase III (mid 80s – mid 90s): Forced Creation of Linkages

By the early 1980s, several structural problems associated with SME support policies were becoming clearer in Malaysia (Chee 1987, Fong 1990, Lall 1996). First, the great majority of local SMEs were in a disadvantageous position vis-a-vis large local enterprises, including TNCs. For example, most SMEs were too small in employee numbers and capital to be able to take advantage of the Investment Incentives Act of 1968. Second, the development of non-Bumiputera SMEs was hindered by the ICA 1975 requirements for enterprises employing more than 24 full-time workers. These requirements discouraged local SMEs, especially local Chinese-owned firms, from making further investment in capital and human resources (Stoever 1986). Third, the increasing focus of local SMEs, especially Bumiputera companies, on domestic market-oriented products prevented them from reaping larger benefits from the outward-oriented industrialisation taking place in Malaysia. Because of these structural problems, the development of local SMEs lagged far behind and was largely disconnected from the successful development of the country's export-oriented industries. As a result, the slow growth of the SME sector became a bottleneck that slowed further development and upgrading of the Malaysian economy (Moha Asri 1999a).

These structural problems were intensified when the Malaysian economy suffered from a serious economic recession in the mid-1980s. To overcome recession, the government sought to attract more TNCs in order to aggressively pursue further export-oriented growth (Edwards & Jomo 1993). To work productively with such TNCs, which required meeting their quality standards, local SMEs were expected to produce more overseas-oriented and high-quality output. Thus, to hasten Malaysian SME development, well-functioning SME support programmes were seriously needed (Meyanathan & Salleh 1994).

The Malaysian government gradually became acutely aware of the adverse effects of the ICA on the expansion, development, modernisation, and technological upgrading of local

SMEs (FMM 2011). Based on this awareness, in 1986 the ICA ceiling was raised to RM 1.0 million or a full-time work force of 49 workers. Thanks to this amendment, a significant proportion of SMEs no longer had to officially comply with the NEP guidelines. In addition to this liberalisation, the Investment Incentive Act of 1968 was replaced by the Promotion of Investment Act in 1986, under which the minimum capital requirements for enjoying incentives were removed. As a result, all SMEs became entitled to benefit from incentives such as tax exemptions, pioneer status, reinvestment allowance for facility expansion, and other advantages. Industrial policies after the mid-1980s thus emphasised the development of all Malaysian SMEs, regardless of whether they were Bumiputera or non-Bumiputera (Meyanathan & Salleh 1994).

The launch of the First Industrial Master Plan (IMP1) in 1985 was an important milestone in the history of Malaysian industrialisation. IMP1 was intended to encourage further development of export-oriented industry (e.g., electronics) and, at the same time, to launch import-substituting heavy industrialisation (e.g., automobiles) in Malaysia. IMP1 was also critical for the development of Malaysian SMEs, as one of its key elements was to modernise ancillary firms and strengthen industrial linkages. Local SMEs that supplied the strategic sectors became a government target for nurturing; for this purpose, IMP1 proposed policy support programmes for SME expansion and modernisation via the provision of financial assistance, improvement of the incentive system, and promotion of R&D activities (MITI 1986).

IMP1 was characterised by two parallel pillars of economic policy: further liberalisation for export-oriented industries and heavy government intervention in the automobile industries (Jomo & Edwards 1993). In line with the first pillar, the incentives for SMEs were further strengthened in the 1989 budget by according 'pioneer' status automatically to all SMEs producing output from a list of designated products, such as electronics items. The 1989 budget also addressed many other measures that discriminated against SMEs. For example, large enterprises located in FTZs were allowed to import components duty-free, a privilege that had not been accorded to local SMEs. This asymmetry distorted costs to the extent that, for TNCs, locally-produced items were more expensive than imported ones, which the 1989 budget corrected by extending the exemptions from import duties for raw materials, components, and parts to SMEs (Meyanathan & Salleh 1994).

In the automobile industry, the Vendor Development Programme (VDP) introduced in 1988 encouraged the emergence of Bumiputera suppliers to Proton, a national car maker established in 1983. Under this scheme, Proton was designated as the "anchor firm," which

obliged it to purchase as many components as possible from qualified Bumiputera SMEs (called the “vendors”) and at the same time to provide Bumiputera vendors with technical and financial assistance. In return, the anchor firm received various benefits from the government, including fiscal incentives and the approval of a large number of expatriate work permits (Felker & Jomo 2007). The VDP was later expanded to more anchor firms, including large electronics firms. This was a semi-forced linkage creation scheme, to which the anchor firms were pressured by the government to contribute. Partly due to the lack of economic rationality and efficiency this SME support system was considered to have achieved only limited success in nurturing competitive local suppliers (Ungku et al. 1998, Felker & Jomo 2007).

Phase IV (after the mid-90s): Upgrading SMEs through Cluster-based Development

After the launch of IMP1, the Malaysian government continued to put greater effort into strengthening the performance of local SMEs by introducing a number of support programmes and incentives covering a wide spectrum of SME needs. In addition to the issue of creating competitive linkages with large TNCs, several other new challenges emerged for Malaysian SMEs, including access to international markets, enhancing technological capabilities, adoption of information and communication technology (ICT), and increasing access to finance. Such new dimensions for SME development called for a broader policy framework, which was embodied in the Second Industrial Master Plan (IMP2) for the period 1996 to 2005 (MITI 1996).

IMP2 formulated two key concepts: “cluster-based industrial development” and “manufacturing plus-plus.” These aimed to enhance growth of the manufacturing sector as a whole throughout the entire value chain. “Cluster-based industrial development” regarded industrial development as a broad system including not only supporting manufacturers but also supporting services, R&D, human skills, infrastructure, institutions, and other economic actors. “Manufacturing plus-plus” was concerned with upgrading each industry’s capabilities in order to achieve more value-added at each node along the value chain. IMP2 called for SMEs to play a vital role in supporting national industrial development throughout the value chains linked with large global firms. These concepts were applied to eight target industries, including electrical and electronics industries (MITI 1996).

Regarding institutional change, the Division of Small Enterprise (DSE) was upgraded to the Small and Medium Industry Development Corporation (SMIDEC) in May 1996. The establishment of SMIDEC was epoch-making in the history of Malaysian SME support

policies. It was expected to play a major role in coordinating the various assistance programmes related to SME development. DES had been set up to fulfil a similar responsibility, but it was no more than a very small division within MITI with insufficient resources to carry out its various programmes. Because numerous different divisions and agencies were involved in SME policies, there was a lack of direction, consistency, effective planning, and systematic policy formation (Shanmugan 1988). Moreover, DSE's orientation was concentrated on domestic market-oriented Bumiputera companies. SMIDEC was Malaysia's first one-stop agency for coordinating all SME-related programmes.

The establishment of SMIDEC was in line with the recognition of the need for a specialised agency to further promote the development of all SMEs as an integral part of nationwide industrialisation. The main tasks of this agency are, among others: i) to coordinate the overall development of SMEs in Malaysia, ii) to promote the development of modern and sophisticated indigenous SMEs in tandem with the strategic direction of industrial development, and iii) to develop Malaysian SMEs into an efficient and competitive sector, capable of producing high value-added and quality products, components, and related services for the global market (Felker & Jomo 2007).

Under the supervision of SMIDEC, which worked with other government agencies, various programmes and financial assistance schemes were introduced. Among these, the Industrial Linkage Programme (ILP) and the Global Supplier Programme (GSP) were widely used⁴⁾. These programmes were closely related to the development and upgrading of SMEs in the electrical and electronics sectors. As of 2002, 953 SMEs were registered in the ILP, among which more than half (50.1%) belonged to E&E sectors, 14.8% to automotive, 24.8% to machinery and engineering, and 24.8% to resource-based industries (VDF 2011)⁵⁾. These figures highlight the relative success of linkage formation in the electrical and electronics sector.

In summary, Malaysian SME support policy has evolved substantially. For a time after independence, there was no political awareness of the need to support local SMEs. With the

4) The Industrial Linkage Programme (ILP) is characterised as a cluster-based industrial development programme prioritising electrical and electronics engineering and resource-based sectors. The main services the ILP provided were (i) financial incentives, (ii) business matching, and (iii) provision of industrial sites. The Global Supplier Programme (GSP) aimed to enhance the capacity and capability of local SMEs to compete at global standards, by providing training in critical skills under linkage with large anchor firms (Ndubisi & Saleh 2006, 21).

5) These percentages add up to more than 100% as there were several companies belonging to more than one sector.

formulation of the NEP, SME support policy was implemented as a means of Bumiputera entrepreneurial development. This was partially successful, but the development of local SMEs was largely disconnected from export-oriented industrialisation. Moreover, the great majority of non-Bumiputera and tiny SMEs were not only ineligible for incentives but also had to comply with ICA requirements which tended to hinder their further growth. Such problems led to a shift in political direction. From the mid-1980s, driven principally by the IMP1 initiative, SME promotion policies were strengthened, liberalised, and made more comprehensive. In 1996, SMIDEC was established as an overarching government agency to organise, supervise, and control all SME policies and administration.

The development of Malaysian manufacturing SMEs has been remarkable in terms of its contribution to employment and value-added in the Malaysian economy, particularly considering its near-zero starting point at the time of independence. As a result, and despite criticism of the overlapping and distorted system of planning and implementing SME support policies, Malaysia has often been lauded for its SME performance (Moha Asri & Bakar 2000, Harvie & Lee 2008). It is debatable, however, how much of this good performance can be attributed to the government's SME support policies.

First, as mentioned above, Malaysian SME support policy has been unduly distorted for several non-economic reasons. The Investment Incentive Act of 1968 placed SMEs at a great disadvantage relative to large firms until 1986. In addition, until the mid-1980s, the policy was strongly ethnically biased – focused predominantly on the development of Bumiputera companies, most of which were in domestic-oriented sectors such as food, furniture production, and services and had few links with export-oriented large firms. Supporting industries producing electric parts, plastic, metal stamping, moulds, engineering, and precision tools were populated mainly by non-Bumiputera, particularly Chinese-Malaysian, firms, whose exclusion from various incentive programmes for a long time may have prevented the full potential of Malaysian SMEs from being realised.

Second, there is the issue of timing: the belated advent of SMIDEC in 1996. Before that, Malaysian SME policies were regarded as inconsistent, disorganised, inefficient, insufficiently resourced, and weak in planning and implementation, problems which the launch of SMIDEC as a well-resourced one-stop coordination agency was intended to solve (Felker & Jomo 2007). Its establishment meant that substantial support programmes were more widely and easily available to local SMEs than ever before (Moha Asri 1999a). However, Malaysian electronics industrialisation began as early as the 1970s or, at the latest, in the early 1980s. This means that the SMEs that became suppliers to TNCs before the mid-

1990s and built the foundation of Malaysia's electronics industrialisation developed mostly by their own efforts, without any significant government support. SMEs which received generous support from SMIDEC appeared only after Malaysian electronics industrialisation was on a stable track, casting doubt on the true contribution the government's SME support schemes.

4. SME Support Schemes: Principles and Malaysian Practice

As of 1999, 13 ministries and nearly 30 government institutions/agencies were involved in offering a wide variety of programmes to promote the development of Malaysian SMEs (Hashim 2002). For analytical purposes, it is convenient to divide these programmes into four broad areas: (i) financial assistance; (ii) training and technical support; (iii) extension and advisory services; and (iv) provision of public goods such as infrastructure facilities (Moha Asri 1999a, Bennett 2014). This section briefly reviews the theoretical basis and design of these four types of programme, while the following section will investigate their actual impact on Penang's E&E industrialisation.

4 (i) Financial assistance

Lack of or limited access to sources of institutional financial credit is recognised as a major obstacle to the initial start-up and subsequent growth of SMEs (Beck & Asli 2006). Major types of financial support activities include credit at an interest rate lower than the market rate, direct subsidies, tax exemptions, and customs relief (Cassar 2004). Along with substantial credit guarantees, governments sometime oblige public and even private banks to allocate a minimum proportion of their lending to target SMEs, at low interest rates and with longer payback terms than usual.

In theory, financial assistance is justified for two reasons: market failure and public welfare (Storey 1994, Bridge et al. 2003, Bennett 2008, 2014). First, financial markets are rarely perfect and far-sighted, and may fail to correctly identify which infant firms have growth potential. This tends to create information asymmetry, which results in such firms having lower levels of financial resources to deploy than would be socially optimal. This kind of market failure is especially frequent in developing countries (Fall 1989), and governments are often expected to take the risk of filling this finance gap. Second, from the perspective of social welfare enhancement, it is often considered desirable that financially weak firms—in an economically disadvantageous position vis-a-vis large or foreign

enterprises—should be subsidised by public bodies. These two reasons often form the justification for government policies of financial support for SMEs.

In Malaysia, under the overall administration of MITI (Ministry of International Trade and Industry), MIDF (Malaysian Industrial Development Finance Berhad⁶⁾) is the central agency in charge of SME finance. Launched in 1960, MIDF introduced soft loan schemes to aid SMEs, such as the Soft Loan for Small and Medium Enterprises (SLSME) and Soft Loan for Factory Relocation (SLFR) programmes. According to the mid-term review of the Eighth Malaysia Plan 2001–2005 (Government of Malaysia 2003), 73% of the total of RM100 million allocated for this purpose was approved for 68 projects. Furthermore, Bank Negara, the Central Bank of Malaysia, formed a special SME unit in 2003 which was to work with the SME Bank, established in 2005 under the control of the Ministry of Finance, to facilitate application and approval processes (Ndubisi & Saleh 2006, Ch.3).

4 (ii) Training and technical support

Successful industrialisation is always based on a large pool of capable and forward-looking entrepreneurs, managers, engineers, and workers who can play a dynamic role in driving sound economic development (Pillai 1994). Such a labour force is valuable not only to small companies but also to large ones. In developing countries, however, it is especially critical for SMEs that aim to compete in global markets in which only qualified and competent firms can survive. Government can play a central role in providing high-quality and affordable education and training programmes. Theoretically, education and training are regarded as public goods with significant positive externalities, whose supply under free market mechanisms tends to be lower than is socially optimal. This is the justification for government-supplied training and technical support (Storey & Westhead 1997).

Training programmes can be broadly divided into two types (Moha Asri 1999a). The first is entrepreneurial development training, which is provided to potential, often novice, entrepreneurs who wish to start new businesses and get them running on a steady track (Kuratko 2005). These programmes include study of how to create and develop business plans, how to identify and access financial resources and potential markets, how to develop and manage human resources, how to analyse business models, and basic management skills.

The second type of training and technical support is technical skill development

6) Berhad (BHD) is a suffix used in Malaysia to indicate a public limited company, while, another suffix, Sendirian Berhad (SDN BHD) is also used to denote a private limited company in Malaysia.

programmes provided for engineers and operators of SMEs (Gibb 1997). These programmes are designed to improve various technical aspects of basic operational skills such as machine handling, processing techniques, equipment and tool selection, handling processes, and other manufacturing techniques. In a broader sense, formal education provides a basis for and encompasses these two types of training.

In Malaysia, several skill development programmes are offered by SMIDEC. These are designed to raise the level of competitiveness and productivity of Malaysian SMEs by upgrading their technological capacity in, for example, ICT, automation, and efficient manufacturing processes. For this purpose, technology advisory services and research and development programmes are offered with grant provisions (Ndubisi & Saleh 2006, Ch.3). At the local government level, the Penang Skills Development Centre (PSDC) is regarded as a highly successful example (Rasiah 1996, 2017). It provides various kinds of training to workers, employees, and managers sent from member companies, financed by the Human Resource Development Fund (HRDF). The PSDC is examined in greater detail in 4 (i) of this section.

4 (iii) Extension and advisory services

Advisory services are follow-up assistance provided to entrepreneurs who have already started new businesses (Robson & Bennett 2000, Bennett 2008) or to the managers of existing SMEs. The small size of SMEs puts them at a disadvantage compared to large firms in developing potential markets and conducting effective marketing activities. SMEs also suffer from a shortage of resources for capturing accurate, broad, and professional information. These disadvantages are seen as justification for government support.

Generally, three types of these services may be defined (Moha Asri 1999a). The first is management consultancy services, including seminars and short courses that teach professional management skills. These are helpful for upgrading business skills such as financial planning, strategy, human resource management, and other general management related activities.

The second type of extension and advisory service is courses related to marketing and market research. These cover topics such as identifying market opportunities, marketing strategy, product innovation and development, attractive packaging design, assessing target customers' buying habits, price promotion, and distribution strategies. The focus is largely on market-orientation programmes that encourage SMEs to manufacture exports, though they provide useful information on potential domestic as well as overseas markets. In

Malaysia, MATRADE (Malaysia External Trade Development Corporation) plays the export-promoting role, providing overseas market information, opportunities to attend overseas exhibitions, and grants for overseas market research. These advisory services also promote greater linkages, especially vertical integration with large firms (Hashim 2015).

The third type of extension and advisory service is courses related to product quality, design, and quality improvement, and to public assistance for obtaining ISO industrial certification. ISO is an internationally-recognised quality control certification system, which can be an important tool for prompting industry to undertake greater self-assessment of production capabilities, identify needs, and seek resources for improvement. The Malaysian government has achieved considerable success in expanding ISO certification among local manufacturing companies through the Standards and Industrial Research Institute of Malaysia, or SIRIM (Ho 1995). SIRIM plays an important role in helping SMEs to improve quality control and productivity. As described below, SIRIM is one of the most widely-used certificate systems in Malaysia for demonstrating quality assurance (World Bank 1997).

4 (iv) Provision of infrastructure and related services

The economic benefits of agglomeration in local or regional industrial clusters including both SMEs and large enterprises are widely acknowledged (Schmitz & Nadvi 1999, Best 2007). Geographical proximity is advantageous in reducing logistics costs and in enabling face-to-face contact among companies that allows collaborative work to be carried out efficiently. Productivity is also enhanced by good local infrastructure, including roads, electricity and water supply, container terminals, telecommunications, testing facilities, and well-designed factory premises, and by “real services” provided by local business associations (Schmitz & Musyck 1994). Where agglomeration and strong infrastructure are lacking, scattered firms incur extra costs of operation and travel time between companies, diminishing overall productivity and limiting growth potential. This provides convincing justification for the setting up of infrastructure and industrial estates which facilitate the agglomeration process (Lee 2011).

In theory, the provision of infrastructure is a core responsibility of government (Mody 1996). One reason for government involvement is that free-rider problems tend to make its supply through market mechanisms lower than would be socially optimal. A second reason is that providing infrastructure in developing countries shapes industrial development by powerfully influencing the type and quality of private investments needed to meet public objectives. To invite and support target enterprises in an industrial zone, for example,

governments usually combine right of tenancy with special incentives and support measures such as provision of industrial premises for fees lower than market rate, commonly-shared production facilities, privileged supply of raw materials and services, exclusive government consulting services, marketing outlets, and specialised technical services (Oman 2000). Typical examples are free trade zone privileges such as tax holidays and duty-free status. Such government support is as important and helpful to local SMEs as it is for larger firms, and perhaps even more so, since they are smaller and weaker.

5. Conclusion: The Role of Government in Supporting SMEs

This paper examines the history and nature of government support programmes for SME development in Malaysia. In line with NEP objectives, early SME policy was designed to increase Bumiputera participation. However, pro-Bumiputera stipulations have been gradually relaxed. At the same time, SME support schemes have been steadily enhanced and better organised. The establishment of SMIDEC in 1996 was a landmark in the history of Malaysian SME policy, as this agency effectively integrated and organised various functions and policies which had previously been run by a number of different agencies and institutes in a decentralised manner.

The general view of the Malaysian government's programmes to support SME development is that they were successful and widely appreciated (Meyanathan & Salleh 1994, Harvie & Lee 2008, Tambunan 2009). The programmes and services surely enhanced the overall productivity of companies and contributed positively to the business climate. However, legitimate doubts have been raised about the effectiveness of the government support. The most convincing evidence of the programmes' limited impact is the fact that a large number of SMEs have demonstrated an ability and strong motivation to go into business and have struggled successfully for survival with no, or very little, support from the government (Oikawa 2021). In particular, no special programmes were available for start-up SMEs. If government policies had been more favourable for SMEs by providing more adequate financing, technical assistance, and extension and advisory services to promising start-ups at the right moment, the growth and development of SMEs would have been greater and more prosperous. Taking from the cases in Penang, this issue will be elaborately examined in Oikawa (2021).

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